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ABSTRACT

Survey data and background information about foundations and corporations are presented. The report, which contains 19 papers, is Volume III in a series examining the relationship between nonprofit institutions and their donors. In the first part of this volume, past and present activities of private foundations are surveyed. A comparative analysis is made of foundation grants and federal expenditures in areas of health, education, science, social welfare services, arts and humanities, and public affairs. Future prospects are reviewed for community and public foundations, and for public funding agencies. In the section on corporations, papers examine the economic, legal, and tax aspects of corporate giving, as well as corporations' social responsibilities. Rationale and issues related to corporate giving are explored. Arguments against corporate contributions include negligible profits and stockholder objections. Arguments in favor of donations include building public respect and improving the climate for business in the community. In the concluding paper, tables illustrate a history of corporate giving since 1935 and a cross-sectional view of corporate giving in 1970. (Author/AV)

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    3. That income deducted for charitable giving should be excluded from any minimum tax provision.
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    4. That the appreciated property allowance within the charitable deduction be basically retained but amended to eliminate any possibility of personal financial gain through tax-deductible charitable giving.
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5. That the charitable bequest deduction be retained in its present form.

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Part I

Special Behavioral Studies

TAX INCENTIVES AND CHARITABLE CONTRIBUTIONS IN THE UNITED STATES: A MICROECONOMETRIC ANALYSIS

Martin S. Feldstein[†] and Charles Clotfelter*

Introduction

This study uses household survey data to estimate the effects of the income tax treatment of charitable contributions. The basic estimates indicate that charitable giving responds to the opportunity cost of giving with a price elasticity of -1.15; the income elasticity is 0.82. These values are quite robust to alternative specifications and to different restrictions of the sample. They are also very similar to the estimates obtained in a previous study using a very different type of aggregate data for 1948 through 1968. An analysis of possible interdependence among individuals reaches the negative conclusion that an individual's total giving does not depend on the amounts given by others at his income level or with higher incomes. The parameter estimates are used to simulate four alternatives to the current tax treatment: complete elimination of the current deduction; replacement of the deduction by tax credits of 20 percent or 30 percent; and constructive realization of gifts of appreciated assets. The analysis shows that because of the current tax treatment, philanthropic organizations receive more in additional funds than the Treasury loses in foregone revenue.

The American public sector relies substantially more on private nonprofit institutions than is common in most other countries. Higher education, health care, the visual and performing arts, and general community services are produced by voluntary institutions. Even when these institutions receive most of their income from user charges and public funds, they depend on private contributions to provide the basic "equity capital" and to support new ventures.[1]

The federal income tax law allows the value of contributions to be deducted in calculating taxable income. The "price" of one dollar's contribution to a philanthropic organization, measured in terms of foregone income after tax, therefore varies inversely with the individual's marginal tax rate. There are today a number of widely discussed proposals for changing the tax treatment of charitable contributions. These include the complete abolition of the deduction, the substitution of a system of tax credits, the introduction of a "floor" with a deduction or credit only for contributions above that level, and various modifications of the tax treatment of appreciated assets.[2] The current paper will not attempt to deal with the complex and wide-ranging issues raised by these proposals. Our focus is on the empirical issue of the magnitude of the price and income elasticities of charitable contributions. These parameters are crucial for the evaluation of the impact of any proposed change.

There has been substantial controversy about the extent to which current tax rules affect the magnitude of charitable contributions. The earliest econometric evidence was Taussig's study of the 1962 Internal Revenue Service Tax File, a stratified sample with 70,596 individual federal income tax returns with itemized deductions.[3] Taussig's often quoted conclusion was that the deduction has little or no effect on the total volume of charitable contributions. More specifically, Taussig's parameter estimates indicated a price elasticity of less than 0.10, and therefore implied that for each dollar of potential revenue foregone by the Treasury, charities receive less than ten cents in contributions. An error in Taussig's analysis, the accidental omission of 22,918 observations, makes this conclusion questionable.[4] There are, moreover, serious problems with Taussig's specification and method of estimation.[5] A reanalysis of the 1962 data with the full sample indicates a price elasticity of approximately one.[6]

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Schwartz used aggregate time series based on the summaries of tax returns that are published by the Internal Revenue Service.[7] The estimated price elasticities differed among income classes and between the pre-war and post-war periods but averaged about 0.6. Unfortunately, the relatively small number of observations and the use of separate samples by income groups precluded precise estimation; more than half of the estimated price elasticities are less than twice their standard error. Feldstein[8] used a time series of cross sections based on the value of itemized charitable contributions in each adjusted gross income class for even years from 1948 through 1968. The estimates indicate that the volume of charitable contributions is quite sensitive to the price of giving that is implied by the tax treatment; almost all of the estimates of the price elasticity are absolutely greater than one.

The studies by Taussig, Schwartz, and Feldstein all suffer from the limits imposed by the use of the official tax return data. Perhaps the most serious problem is the lack of information on permanent economic income and on wealth. Adjusted gross income becomes a less adequate measure as income rises. Similarly, the influence of wealth rather than current income is likely to be important at high income levels. A second important shortcoming is the restriction to taxpayers with itemized returns. While this restriction is unimportant for high-income individuals, it eliminates substantial information on the behavior of those with lower income. Demographic characteristics (age, sex, marital status, and race), educational background, occupation, and other personal attributes that influence giving may be correlated with income and price variables in a way that biases the estimates of the price and income elasticities.

The current study presents a new type of evidence about the effects of the income tax treatment of charitable contributions that avoids the restrictions imposed by the official tax return data. By using household survey data, we are able to relate charitable giving to economic income, wealth, tax rates, and personal characteristics. It is very reassuring that the estimated price elasticities are very close to the values obtained in Feldstein[9] despite the substantial differences in the nature of the data and the level of aggregation.

Chapter I describes the survey data and indicates the definitions used to construct the key variables. Chapters II, III, and IV present the basic parameter estimates and examine whether the price elasticity varies among wealth or income groups. The special problem of gifts of appreciated property is studied in detail. Chapter V specifies and estimates alternative models of interdependent behavior in which each individual's contribution depends on the volume of contributions made by others. Simulations of the effects of four possible tax changes are presented in Chapter VI. There is a brief concluding section.

I

DATA, SPECIFICATION AND DEFINITIONS

In 1963 and 1964 the Board of Governors of the Federal Reserve System conducted a national survey of the income, assets, and savings of 2,164 households.[10] With the assistance of the Internal Revenue Service, the survey was able to greatly oversample high-income individuals; for example, 18 percent of the sample but less than 1 percent of the population had 1962 incomes over $25,000. For the current analysis we eliminated a relatively small number of households that did not report one or more key variables (charitable giving, income, age, children, and saving) or that reported a negative net worth. A further group with very low 1963 adjusted gross income (less than \$1,721) was also eliminated.[11] The final sample contains 1,406 households.

The equations that we have estimated relate charitable giving (G) to disposable income (INC), the price of giving, that is, net cost to the donor per dollar received by the donee (P), net worth (W), and additional variables measuring age and other personal characteristics (X). The basic specification uses a log-linear equation to estimate constant elasticities with respect to INC, P, and W:

$$\ln G_i = \beta_0 + \beta_1 \ln INC_i + \beta_2 \ln P_i + \beta_3 \ln W_i + \sum_{j=4} \beta_j X_{ji} + \epsilon_i \qquad (1)$$

Alternative specifications allowing more general nonlinear relations will be described below.

The survey obtained information on all charitable giving in 1963 (G), including gifts of assets as well as of cash. The survey estimate of aggregate giving agreed quite closely with the official Internal Revenue Service value; for itemized returns, actual 1962 giving was \$7.5 billion and the corresponding survey estimate for 1963 was \$6.2 billion.[12] One can only speculate on how much of the difference is due to underreporting in the survey and how much to overreporting in the tax returns.[13] In principle, the survey contains information on the value of gifts to trusts but it is not clear how accurately this information reflects the actual value of such gifts. There is no information on gifts of services, gifts made by corporations that the donors control, or anticipated testamentary bequests.

The correct concept of disposable income for this study is total income minus the taxes that would be due if no charitable contributions were made.[14] The basic measure of disposable income (YD) in this study uses total income received in 1963 minus an estimate of the tax that would be due with no contribution; the method of estimating the tax is described below. To approximate permanent income, an average of this disposable income measure for 1962 and 1963 has also been used: YDP = 0.5 (YD + YD62).[15]

There are two disadvantages with this common measure of permanent income: (1) it uses only income received and excludes the accrued gains on various assets; and (2) it uses only two years' income data while the individual may base his own perception of permanent income on much more information. The first of these may not be a very serious problem because the basic specification of equation 1 includes the value of wealth. Nevertheless, this does not allow for the fact that different portfolios have different amounts of accrued income and realized income nor for the differences in the contribution of wealth to permanent income at different ages. We have therefore constructed as an alternative measure of permanent income the value of the annuity that the individual could obtain from his current wealth and labor income. More specifically, YDA is the sum of the current labor income and the annual payment of an annuity based on the head of the household's age and an interest rate of 5 percent, net of the tax that would be due if no charitable contributions were made.[16]

The annuity measure of permanent income is still restricted to using current labor income to approximate permanent labor income. A quite different approach to measuring permanent income can be based on the permanent income theory of consumption. Because of the log-linear form of equation 1, we must restate the permanent income model in a multiplicative form:

$$\tilde{C} = k\, YP\tilde{U} \qquad (2)$$

$$\tilde{Y} = YP\tilde{V} \qquad (3)$$

where $\tilde{C}$ is actual consumption, YP is permanent income, $\tilde{Y}$ is actual income and $\tilde{U}$ and $\tilde{V}$ are multiplicative random errors. In addition, $\ln U$ and $\ln V$ are independent of each other and of $\ln YP$. If permanent income is more closely correlated with current consumption than with current income, it is advantageous to replace INC in equation 1 by consumption and to use current income as an instrumental variable in the estimation procedures.[17] For this method of measuring permanent income, we include charitable contributions in the definition of total consumption[18] and use YD as the measure of current income.

The price of charitable giving (P) is the amount of after-tax income or wealth that the individual foregoes to add one dollar to the receipts of a donee. If the individual uses the "standard deduction," that is, if he does not itemize his deductions, his price is 1 regardless of his marginal rate. If the individual itemizes his deductions and his marginal rate is m, the price of a one dollar cash contribution is 1-m. For this purpose, we define m as the marginal rate applicable to the first dollar of charitable contributions. An individual who gives a very substantial amount in relation to his income will lower his marginal rate as well as his tax liability. We have not investigated the implications of using an endogenous value of P based on the last dollar of giving or the average cost for the entire gift.[19]

Contributions of appreciated assets create a special problem for measuring the price of charitable giving. When an asset is given away, its full value can be deducted from the donor's taxable income but there is no constructive realization and therefore no tax to be paid by the donor on the capital gain.[20] The opportunity cost (price) of a gift that is given in the form of an appreciated asset therefore depends not only on the individual's marginal tax rate but also on the fraction of the asset's value that is accrued capital gain and on the alternative disposition of the asset. An example will clarify the way in which these variables determine the relevant price. Consider an individual whose marginal rate is 40 percent and who contemplates donating an asset that is now worth $100 and for which he originally paid $30. If he gives the asset away, he reduces his taxable income by $100; he therefore reduces his tax liability by $40 and thus increases his after-tax income by $40. If he instead sells the asset, he pays a tax of $14 (half of his marginal rate on the capital gain of $70) and increases his after-tax income by $86. For this individual, the opportunity cost of the $100 contribution is therefore $46 of foregone consumption. If the price is defined in terms of foregone consumption, the price of the gift is $P=0.46$. This price clearly depends on the ratio of the asset's original cost (or basis) to its current value: an original cost of $1 implies $P=0.40$ while an original cost of $100 implies $P=0.60$. More generally, $P=1-mc(1-B/V)-m$ where V is the current value of the asset, B is its basis or original cost, m is the marginal tax rate on income and mc is the marginal tax rate on capital gains; in 1963, $mc = 0.5m$ with a maximum of 0.25.

The preceding calculation defined the opportunity cost of a donated asset in terms of foregone immediate consumption, that is, it assumed that if the asset were not given away it would be sold in the current year. The price is higher and the calculation is more complex if the opportunity cost is defined in terms of foregone saving or wealth, that is, if it is assumed that the asset would not otherwise be sold in the current year. The individual in the preceding example could retain the $100 asset or he could give it away and add the $40 tax saving to his wealth. Viewed in this way, his opportunity cost price is 0.60, the same as for contributions of money; moreover, this price is independent of the ratio of the capital gain to the present asset value. Since the individual who does not give away the asset also has a future tax liability, this tends to overstate the opportunity cost of a prospective contribution. However, by postponing the sale of the asset the individual can substantially lower the present value of the tax, and if the asset is never sold during the individual's lifetime, the capital gains tax liability is completely eliminated when the asset passes at death.[21]

It has not been possible to reflect accurately the full complexity of appreciated asset gifts. Although the fraction of total contributions in the form of assets is known for each individual, there is no data on the ratio of original cost to the current value for such assets. There is of course no information on what would have been done with such assets if they had not been contributed. The price of gifts of appreciated assets can therefore be known only conditional on an assumed ratio of basis to value. Moreover, with the same ratio of basis to value for all households, the prices of cash gifts and of asset gifts are very highly correlated. In practice, we have constructed a price index as a weighted average of the cash price and asset price using the share of contributions in the form of assets for all households in the same broad income class.[22] A maximum likelihood procedure, described below, was used to estimate an appropriate ratio of basis to current value.

The survey did not specifically ask for the individual's marginal rate or taxable income or even whether the taxpayer itemized his deductions. To estimate this information we begin by calculating adjusted gross income (AGI) as the sum of income from all taxable sources plus short-term capital gains plus half of long-term capital gains.[23] We then classify the taxpayer as an itemizer or non-itemizer in the following way.[24] We calculate the exemptions and standard deduction that the taxpayer would have if he did not itemize and find the resulting tax liability by consulting the appropriate tax schedule. We then estimate the taxpayer's potential deductions (excluding charitable contributions) as the sum of 5 percent of the value of owned residences[25] plus a percentage of AGI that varies by AGI class to represent other itemizable deductions.[26] The tax liability, if the taxpayer itemizes, is then calculated and compared with the liability if the standard deduction is used. The taxpayer is assumed to choose the method that minimizes his tax liability. The appropriate tax schedule then defines the marginal tax rate and the corresponding rate for capital gains.[27]

Each family's net worth (W) is defined as the algebraic sum of the value of portfolio and other investment assets, business assets, real estate and automobiles, minus the value of all debts. This definition thus omits consumer durables (except automobiles), the cash value of life insurance, and the present value of future pension rights and social security benefits.

The remaining variables will be defined as they are introduced.

II

THE BASIC PARAMETER ESTIMATES

Parameter estimates for the sample of 1,406 households are presented in equation 4:

$$
\begin{aligned}
\ln G = -5.42 &+ \underset{(0.15)}{0.80} \ln YD - \underset{(0.31)}{1.55} \ln P \\
&+ \underset{(0.06)}{0.10} \ln W + \underset{(0.21)}{0.12}\, AGE3554 + \underset{(0.25)}{0.25}\, AGE5564 \qquad (4)\\
&+ \underset{(0.30)}{0.49}\, AGE65+
\end{aligned}
$$

$$R^2 = 0.20$$
$$N = 1406$$

The income elasticity is 0.80 and the price elasticity is -1.55; despite the potential problem of collinearity between income and price, the standard errors of the elasticities are quite small. Although the wealth elasticity is relatively low, the very substantial range of wealth within each income class implies that wealth differences are responsible for a substantial part of the variation in contributions. Although the individual age dummies are not statistically significant, the coefficients suggest that giving rises substantially with age: families in which the head is between 35 and 54 years old give 12 percent more than similar families in which the head is under 35; for 55 to 64 year olds, the difference is 25 percent, and for those over 65 the difference is 49 percent.

Table 1 compares the basic parameter estimates for different definitions of income and price using the same specification as equation 4. The constant terms and the coefficients of wealth and of the age variables are not shown. The price elasticity of approximately -1.5 is essentially unaffected by the choice of income definition (equations 1.1 through 1.4).

Table 1

Price and Income Elasticities of Charitable Giving
Based on Alternative Definitions of Price and Incomes

Equation	PRICE		INCOME		SSR
	Definition	Elasticity	Definition	Elasticity	
1.1	P	-1.55 (0.30)	YD	0.80 (0.15)	9836
1.2	P	-1.57 (0.30)	YPD	0.83 (0.15)	9823
1.3	P	-1.54 (0.31)	YDA	0.79 (0.15)	9856
1.4	P	-1.44 (0.31)	$\hat{C}$	0.95 (0.17)	9836
1.5	P[50]	-1.14 (0.20)	YD	0.84 (0.14)	9792
1.6	P[50]	-1.15 (0.20)	YPD	0.87 (0.14)	9780
1.7	P[50]	-1.10 (0.21)	YDA	0.81 (0.15)	9832
1.8	P[50]	-1.07 (0.20)	$\hat{C}$	0.99 (0.16)	9793

The equations all contain a constant term, a wealth variable and age variables. All estimates relate to the sample of 1,406 observations.

The price variables are: P = 1–m where m is the marginal tax rate; P50 is a weighted average of P and 1–m–0.50 mc where mc is the marginal rate for capital gains, if an asset test is satisfied, and P if the test is not satisfied. For non-itemizers, P = 1. The income variables are: disposable income (YD), permanent disposable income (YPD), disposable annuity income (YDA) and consumption with an instrumental variable estimator (C). See text for additional details.

Before considering the implication of these elasticity values, it is important to study the alternative price definitions that reflect the contribution of appreciated assets.

The special problems raised by gifts of appreciated property were briefly discussed in Chapter I. The available data severely limits the possibility of dealing fully with this problem. The price for the gift of appreciated property that would otherwise be sold is $1-m-mc(1-B/V)$ where mc is the marginal tax rate on capital gains and B/V is the ratio of the basis (usually cost) to the current value of the asset. There is unfortunately no data on the B/V ratio for property gifts. Moreover, if the asset would not otherwise be sold immediately, the present value of the reduction in the capital gains tax is less than $mc(1-B/V)$. If we denote the present value of this reduction in the capital gains tax by $\alpha mc(1-B/V)$ where $0 \leq \alpha \leq 1$ is the relevant discount factor, the price of a gift of appreciated property is $1-m-\alpha \cdot mc \cdot (1-B/V)$. Since nether α nor B/V is known and since only their product enters the price variable, we have used a maximum likelihood search procedure (described below) to estimate the composite parameter $\alpha(1-B/V)$. The value of $\alpha(1-B/V)$ is assumed to be the same for all taxpayers.

For any given value of $\alpha(1-B/V)$ there is still a problem of how to combine the separate price variables for gifts of cash and for gifts of appreciated property. Although the price for gifts of property is always less than the price for cash gifts, individuals who make gifts of property almost always also make gifts of cash. These individuals may prefer cash gifts for contributions below some minimal size or for contributions to particular types of donees. Since there is very high correlation between the two prices,[28] it is better to use a weighted average of the two prices than to use the two prices separately. The relative importance of the two prices clearly differs among the income classes: the survey indicates that gifts of assets accounted for less than 1 percent of total giving by households with income below \$15,000 but for more than 60 percent of total giving by households with income over \$100,000. Although weights could be assigned to each taxpayer on the basis of the composition of that taxpayer's gifts, doing so would introduce a very substantial element of inappropriate simultaneity in the definition of price. Instead, households are classified into seven income classes with the relative weights for all households in each class based on the average composition of the gifts in that class.

Not all taxpayers can take advantage of the option to contribute appreciated property. An individual who does not own common stock is unlikely to have an appreciated asset that is suitable for making charitable gifts.[29] As a precautionary measure, we assume that any taxpayer who does not have common stock worth at least 3 percent of his adjusted gross income will make only cash gifts.[30]

The final price variable will be written $P[\alpha(1-B/V)]$ to emphasize that it is conditional on the parameter $\alpha(1-B/V)$. The variable is defined by:

$$\begin{aligned} P[\alpha(1-B/V)]_i &= 1 \text{ for non-itemizers} \\ &= 1-m_i \text{ for itemizers with insufficient common stock} \qquad (5) \\ &= W_i(1-m_i)+(1-W_i)\,[1-m_i-\alpha(1-B/V)mc_i] \text{ for others} \end{aligned}$$

where the weight W_i is the ratio of the value of cash gifts to total gifts for the income class of which household i is a member. For eight values of $\alpha(1-B/V)$ between zero and one, the logarithm of $P[\alpha(1-B/V)]_i$ is substituted for $\ln P_i$ in the basic specification of equation 4. The value of $\alpha(1-B/V)$ for which the regression has the lowest sum of squared residuals is the maximum likelihood estimate of this composite parameter and the estimated coefficients for this value are the maximum likelihood estimates of the corresponding parameters.[31]

The likelihood function is relatively flat between $\alpha(1-B/V)=0.25$ and $\alpha(1-B/V)=0.75$ but reaches a maximum at $\alpha(1-B/V)=0.50$. The income, wealth, and age coefficients are not substantially different from the results obtained in equation 4 with the simple price variable. The price elasticity falls from 1.55 to 1.14 (S.E. = 0.20). This specification implies a smaller response to any given change in price. The estimated price elasticity is again quite insensitive to the definition of income (see equations 1.5 through 1.8).

The alternative definitions of income have little effect on the estimated price elasticity. Because permanent disposable income (YPD) corresponds to the lowest sum of squared residuals, we present the full equation:

$$\begin{aligned}
\ln G = -5.90 &+ \underset{(0.14)}{0.87} \ln YPD - \underset{(0.20)}{1.15} \ln P(50) \\
&+ \underset{(0.05)}{0.10} \ln W + \underset{(0.21)}{0.14}\, AGE3554 + \underset{(0.26)}{0.26}\, AGE5564 \qquad (6) \\
&+ \underset{(0.30)}{0.45}\, AGE65+
\end{aligned}$$

$$\begin{aligned}
R^2 &= 0.21 \\
N &= 1406 \\
SSR &= 9792
\end{aligned}$$

The wealth and age coefficients are almost identical to those of equation 4 and are thus not sensitive to the measurement of income or price.

Before studying additional modifications of this basic equation, it is useful to consider the implications of these elasticity values. Since a full analysis is presented in Chapter IV, only some individual examples are now examined. In 1963 households with incomes between \$8,000 and \$10,000 contributed an average of \$165. The average price for these taxpayers was 0.84. If contrbutions were not deductible, the price would rise by 19 percent (from 0.84 to 1.00) and therefore, given a price elasticity of -1.15, contributions would fall by about 18 percent or \$30.[32] This amount is neither implausible nor contrary to the common assertion that the deductibility of contributions is likely to have only a "small" effect on the amount given by low-income households.[33]

For households with disposable income between \$25,000 and \$50,000, the average contribution was \$2,125 and the average price was 0.49. The lower average price in this income class implies that the deductibility of charitable gifts has a substantially greater effect than in the lower income class. Eliminating the deductibility would raise the price by 104 percent (from 0.49 to 1.00) and would therefore lower the contribution by about 56 percent or \$1,190.

It is interesting to note the special implication of a price elasticity of exactly minus one. With this price elasticity, the value of giving responds to changes in price in such a way that the *net* cost to the individual donor is unaffected by the deductibility. Donees receive an amount equal to the sum of the constant net cost to the donors plus the revenue foregone by the Treasury. The efficiency of the incentive to charitable giving, that is, the ratio of additional funds received by donees to revenue foregone by the Treasury, is 100 percent. The actual estimated price elasticity of -1.14 implies an efficiency greater than 100 percent, that is, philanthropic organizations receive more in additional funds than the Treasury loses in foregone revenue.

In concluding this section, it is useful to compare the current parameter values with the estimates based on aggregate data by income class for the years 1948 through 1968. Feldstein reported an income elasticity of 0.82 (S.E.=0.03) and a price elasticity of -1.17 (S.E.=0.09).[34] The two estimates are remarkably close to the current values of 0.87 and -1.15 in spite of the great differences in the source of the data and level of aggregation.

III

ADDITIONAL SPECIFICATIONS AND TESTS

This section and the next test the sensitivity of the basic results to a number of generalizations of the specification and restrictions of the sample. The evidence all tends to confirm the conclusions that the price elasticity is slightly greater than one and that the income elasticity is slightly less than one. We begin by restricting the sample, first to taxpayers who itemize and then to taxpayers under age 60. A variety of demographic factors associated with giving are examined next. Chapter IV considers alternative specifications in which the price and income elasticities are allowed to vary with income and wealth.

Taxpayers With Itemized Deductions

A taxpayer who does not itemize his deductions has a price of 1 for all charitable contributions. Chapter I explained how we decided whether each household would (in the absence of any charitable contributions) have itemized its deductions or used the standard deduction. A total of 486 of the original 1,406 households were treated as non-itemizers. To see whether the price effect of itemizing is similar to the price effect due to the variation in the marginal rate for itemizers, we reestimated the basic regression for the sample of 920 households who itemized (and would have itemized even in the absence of charitable contributions). The price and income elasticities of equation 7 are very similar to the values for the entire sample that were presented in equation 6. The itemizers' income elasticity

$$
\begin{aligned}
\ln G = -4.80 &+ \underset{(0.20)}{0.93}\ \ln YPD - \underset{(0.24)}{1.39}\ \ln P50 \\
&+ \underset{(0.09)}{0.09}\ \ln W + \underset{(0.30)}{0.40}\ AGE3554 + \underset{(0.35)}{0.42}\ AGE5564 \qquad (7) \\
&+ \underset{(0.42)}{0.84}\ AGE65+
\end{aligned}
$$

$R^2 = 0.18$
$N = 920$
Itemized Returns

is a little higher than for the full sample (0.87) and the price elasticity is also slightly higher than the value of 1.15 obtained for the full sample. Although this suggests a somewhat stronger response to changes in marginal rate than to itemizing per se, the difference is very small and well within the standard error of the parameter estimate.

Aged and Nonaged Taxpayers

It seems plausible that the philanthropic behavior of older taxpayers may differ substantially from the behavior of younger ones. Decisions about current giving and charitable bequests are likely to be more interdependent than at earlier ages.[35] Current income may be a very poor measure of permanent income and current giving may reflect patterns established earlier in life. For both reasons, wealth may be more important than at younger ages. Our sample contains 304 households in which the head was 60 years old or older.[36] Equation 8 shows that the behavior of this group is not fundamentally different from that of younger households:

$$\begin{aligned} \ln G = -6.12 &+ \underset{(0.26)}{0.79} \ln YPD - \underset{(0.30)}{0.84} \ln P50 \\ &+ \underset{(0.14)}{0.22} \ln W + \underset{(0.33)}{0.13}\, AGE65+ \end{aligned} \tag{8}$$

$$\begin{aligned} R^2 &= 0.27 \\ N &= 304 \\ SSR &= 2346 \end{aligned}$$

The income and price elasticities are somewhat smaller and the wealth elasticity is substantially larger than in the entire sample. The size of the sample (N=304) results in larger standard errors and the usual analysis of variance test shows that dividing the population into aged and nonaged does not significantly improve the explanatory power of the model.[37]

Other Demographic and Economic Factors

The survey data provide other information about the demographic and economic attributes of each household. An analysis of the effects of these factors on charitable giving is both interesting in its own right and useful as a way of testing whether the previously observed price and income elasticities are biased because of the simpler specifications. For this purpose, households have been classified with respect to seven factors in terms of the characteristics of the head of the household: age, sex, race, community size of residence, employment, home ownership, and education.

Table 2 shows that allowing for the influence of these factors has almost no effect on the estimated price, income, and wealth elasticities. In particular, the price elasticity of -1.098 is extremely close to the value of -1.15 obtained in equation 6 when the other explanatory variables are omitted. The additional variables are themselves also generally insignificant: only 6 of the 11 coefficients exceed their standard error and only one is more than twice its standard error. The one factor with a substantial effect is community size: households in medium-size cities contribute the most (given their income, price, wealth, and other characteristics) while households in large cities contribute the least.

The insignificant impact of factors such as home ownership and education appears contrary to the common observation that home owners and college graduates give more than renters and than those who did not graduate from college. Such observations do not of course adjust for the effects of price and wealth. Column 3 presents the unadjusted average[38] gifts in each group. These averages conform to the usual presumptions. For example, college graduates contribute more than three times as much as nongraduates and the difference of $275 is more than four times the standard error. Comparing columns 1 and 3 thus shows that many of the factors associated with greater contributions are simply indirect reflections of income.

Table 2

Effects of Demographic and Economic Factors on Charitable Giving

	Adjusted Effects		Unadjusted Effects	
	Coefficient (1)	Standard Error (2)	Mean ($) (3)	Standard Error (4)
Income (ln YPD)	0.772	0.156	–	–
Price (ln P50)	-1.098	0.201	–	–
Wealth (ln W)	0.095	0.057	–	–
Age				
<35	–	–	91	(48)
35-54	0.170	(0.212)	159	(33)
55-64	0.300	(0.258)	169	(54)
65 +	0.466	(0.320)	247	(65)
Sex				
Male	-0.085	(0.264)	163	(24)
Female	–	–	98	(70)
Race				
White	0.250	(0.184)	166	(25)
Nonwite	–	–	111	(55)
Community Size				
<250,000	–	–	103	(35)
250,000-1,000,000	0.517	(0.157)	211	(33)
>1,000,000	-0.257	(0.246)	123	(72)
Employment				
Self-employed	0.161	(0.200)	268	(58)
Employee	–	–	133	(26)
Not working	0.138	(0.318)	161	(77)
Home ownership				
Renter	0.005	(0.189)	104	(39)
Owner	–	–	182	(28)
Education				
College graduate	0.293	(0.201)	397	(64)
Others	–	–	122	(24)

IV

VARYING PRICE ELASTICITIES

The specification of a constant price elasticity is clearly an assumption of convenience. We have therefore examined several alternative specifications in which the price elasticity is allowed to vary as a function of income, price, and wealth. Although there is some variation in the price elasticity, the evidence supports the conclusion that the average elasticity is approximately one.

Three different forms of varying price elasticity have been estimated. The first modifies the basic specification by replacing the constant price elasticity by a price elasticity that varies linearly with logarithm of income, price or wealth. For example, when the price elasticity is posited to depend on price we obtain:

$$
\begin{aligned}
\ln G = -5.85 &+ \underset{(0.14)}{0.86} \ln YPD - (\underset{(0.44)}{1.16} + \underset{(0.106)}{0.004} \ln P50) \ln P50 \\
&+ \underset{(0.056)}{0.096} \ln W + \underset{(0.21)}{0.14}\, AGE3554 + \underset{(0.26)}{0.26}\, AGE5564 \\
&+ \underset{(0.30)}{0.45}\, AGE65+
\end{aligned}
\tag{9}
$$

$$
\begin{aligned}
R^2 &= 0.21 \\
N &= 1406 \\
SSR &= 9780
\end{aligned}
$$

The coefficient of ln P50 varies only very slightly with ln P50 and the additional coefficient is very much smaller than its standard error. Using the same form of the equation to allow the price elasticity to vary with income (YPD) or wealth also produces completely insignificant effects. Even if the large standard errors are ignored, the magnitude of these effects is relatively small. At the sample mean income, the price elasticity is -1.08; a 50 percent change from this income only alters this elasticity by 0.02. Similarly, at the sample mean wealth, the price elasticity is -1.21 and a 50 percent change in wealth only alters the price elasticity by 0.01.

The second method of generalizing the constant price elasticity specification is to reestimate the basic equation with different price elasticities in different parts of the price range. For this purpose, the observations are grouped into those for which price exceeds 0.70, those for which price is between 0.30 and 0.70, and those for which price is less than 0.30. Equation 10 shows that each of the separate price elasticities is now absolutely greater than the overall value of -1.15 but that the differences are not statistically significant: the F ratio of 0.65 is less than the 5 percent critical value of $F(2,\infty) = 2.99$.

$$
\begin{aligned}
\ln G = -5.97 &+ \underset{(0.15)}{0.88} \ln YPD - \underset{(0.20)}{1.16} \ln P50\,(<0.3) \\
&- \underset{(0.42)}{1.26} \ln P50(0.3\text{–}0.7) - \underset{(0.64)}{1.82} \ln P50\,(>0.7) \\
&+ \underset{(0.057)}{0.084} \ln W + \underset{(0.21)}{0.13}\, AGE3554 + \underset{(0.26)}{0.26}\, AGE5564 \\
&+ \underset{(0.30)}{0.48}\, AGE65+
\end{aligned}
\tag{10}
$$

$$
\begin{aligned}
R^2 &= 0.21 \\
N &= 1406 \\
SSR &= 9771
\end{aligned}
$$

where ln P50(<0.3) is either the logarithm of P50 if P50 is less than 0.3 or is equal to zero and ln P50(0.3–0.7) and ln P50(>0.7) are defined similarly.

Similar equations with separate price elasticities for different income and wealth were also estimated. In equation 11, there are separate price elasticities for households with incomes below \$8,000, between \$8,000 and \$40,000, and above \$40,000. The price elasticities vary substantially but have large standard errors. The

$$
\begin{aligned}
\ln G = -6.91 &+ \underset{(0.16)}{0.99} \ln YPD - \underset{(0.80)}{2.07} \ln P50\,(inc < 8000) \\
&\underset{(0.32)}{-0.75} \ln P50(8000 < inc < 40{,}000) - 1.16 \ln P50(inc > 40{,}000) \\
&\underset{(0.06)}{+0.09} \ln W + \underset{(0.21)}{0.14}\, AGE3554 + \underset{(0.26)}{0.26}\, AGE5564 \qquad (11) \\
&\underset{(0.30)}{+0.47}\, AGE65+
\end{aligned}
$$

$$
\begin{aligned}
R^2 &= 0.21 \\
N &= 1406 \\
SSR &= 9750
\end{aligned}
$$

substitution of the three price elasticities for the single price elasticity only reduces the sum of squared residuals from 9792 to 9750; the associated F statistic of 3.01 is just significantly different from zero at the 5 percent level (the critical value is 2.99). Each coefficient is significantly less than zero but not significantly different from -1. Only for the middle-income group is the estimated elasticity smaller than the value of -1.15 obtained for the entire sample; the point estimate of -0.75 has a standard error of 0.32.

Equation 12 shows that price elasticities decrease as wealth increases. Households with net worth less than \$10,000 have an estimated price elasticity of -3.2 while households with wealth between \$10,000 and \$100,000 have a price elasticity of -1.68 and those with higher wealth have a price elasticity of -1.09. Although the standard errors are relatively large for the first two estimates, the three coefficients are significantly different from each other; the F statistic of 4.45 is significant at less than the 0.01 level. Although the value of -3.2 for low-wealth households seems inappropriately large, it should be noted that the average price for this group is 0.91 so that even a price elasticity of -3.2 only implies that the tax deductibility of contributions raises giving by 35 percent.

$$
\begin{aligned}
\ln G = -6.12 &+ \underset{(0.14)}{0.86} \ln YPD - \underset{(0.85)}{3.22} \ln P50\,(W < 10{,}000) \\
&\underset{(0.45)}{-1.68} \ln P50\,(10{,}000 < W < 100{,}000) - \underset{(0.20)}{1.09} \ln P50\,(W > 100{,}000) \\
&\underset{(0.06)}{+0.11} \ln W + \underset{(0.21)}{0.12}\, AGE3554 + \underset{(0.26)}{0.28}\, AGE5564 \qquad (12) \\
&\underset{(0.30)}{+0.53}\, AGE65+
\end{aligned}
$$

$$
\begin{aligned}
R^2 &= 0.21 \\
N &= 1406 \\
SSR &= 9730
\end{aligned}
$$

The third and most general specification is to allow all of the coefficients to be different in different income and wealth classes. Table 3 compares the income, price, and wealth elasticities for the separate population groups with the values obtained for the entire sample; each equation also contains a constant term and three age variables.

Although there are rather substantial elasticity differences among the income classes, the standard errors of these coefficients are large and the disaggregation is not statistically significant; the F ratio of 1.27 is less than the 5 percent critical value of F(14,∞) = 1.69. Moreover, in considering the very high price elasticity in the low income group, it should be borne in mind that this group has an average price of 0.89, so that even a price elasticity of −2.5 implies that the tax deductibility of charitable contributions only raises the average value of the gifts by 34 percent.

Table 3

Price, Income, and Wealth Elasticities in
Different Income and Wealth Groups

Eq.	Sample	Price	Income	Wealth	SSR	N
3.1	All households	-1.15 (0.20)	0.87 (0.14)	0.10 (0.05)	97[illegible]	1406
	Income					
3.2	<$8,000	-2.50 (0.91)	0.84 (0.25)	0.09 (0.07)	3719	673
3.3	$8,000 - $40,000	-0.89 (0.41)	0.81 (0.35)	0.08 (0.11)	5224	654
3.4	$40,000 +	-0.70 (0.39)	2.79 (1.56)	0.36 (0.31)	713	79
	Net worth					
3.5	<$10,000	-3.69 (0.92)	0.[illegible]5 (0.26)	0.078 (0.087)	2869	542
3.6	$10,000 - $100,000	-1.83 (0.62)	0.59 (0.22)	-0.003 (0.195)	4402	634
3.7	$100,000 +	-0.52 (0.31)	1.81 (0.44)	0.48 (0.27)	2277	230
3.8	$100,000 + } Age <60 }	-1.09 (0.51)	1.12 (0.72)	0.31 (0.36)	1389	131

The results are similar for the disaggregation by wealth groups. Although the elasticities differ substantially, the standard errors are quite large. The reduction in the sum of squared residuals is relatively small (9548 for the three equations in comparison to 9780 for the combined equations) but statistically significant (F=2.4 and the critical value at 5 percent is F(14,∞)=1.69). The very high price elasticity for the lowest wealth group is again associated with a price that reflects almost no effect of the tax: the average price in this group is 0.91, implying that even if the price elasticity is −3.69 the tax deductibility of contributions only raises giving by 42 percent. Although the high standard error of this price elasticity serves as a warning against accepting the point estimate, there is strong evidence that the price elasticities for families with wealth of less than $100,000 are greater than unity.

The relatively low price elasticity for the wealthiest group reflects the very large fraction of older persons in this sample of wealthy households. Equation 3.8 shows that for households in which the head is less than 60 but net worth exceeds $100,000, the price elasticity is −1.09, essentially the same as for the whole sample. It is the wealthy aged for whom the complex interaction between estate taxes and income taxes makes the current model least appropriate; only further work on data that links bequests and lifetime giving will be able to provide an estimate of the price elasticity for this group with an adequate adjustment for the effect of estate taxes.[39]

V

INTERDEPENDENCE AMONG INDIVIDUALS IN CHARITABLE GIVING

It is widely believed that the amount that each individual contributes to charity is substantially influenced by the amounts that he perceives others to be giving. Social experiments confirm that individuals on the street who do not know they are participating in an experiment are more likely to make charitable contributions if they have just witnessed someone else making a contribution.[40] Fund raisers emphasize the importance of "leadership gifts," large gifts by some high-income individuals that motivate similar individuals to make comparable gifts and lower income individuals to make gifts that are larger than they would otherwise make.

It is not clear, however, whether this demonstration effect appreciably alters each individual's total giving or only changes the distribution among different charities. The existence of an interdependence among individual behavior is both an interesting question in itself and a matter of substantial importance for the impact of alternative tax treatments of charitable contributions. If each individual's giving does depend postively on the gifts of individuals with the same or greater income, an increase in the price of giving for the highest income groups will not only depress their giving but would also depress the giving of lower income individuals as well.

The current section extends the previous specification to a model in which each individual's giving is a function of the average giving in his own income class and in the income classes above him. More specifically, to the previous equation we add the variable

$$g_i^* = \frac{\sum_j W_{ij} \ln \bar{G}_j}{\sum_j W_{ij}} \tag{13}$$

where $\bar{G}_j$ is the mean giving per household in income class j and W_{ij} measures the "economic proximity" of individual i and income class j. The summation is taken only for the individual's own income class and the classes above him.[41] The economic proximity is defined by

$$W_{ij} = \left(\frac{\bar{Y}_i}{\bar{Y}_j}\right)^{\lambda}, \quad \lambda \geq 0, \tag{14}$$

where $\bar{Y}_j$ is the mean income in income class j and $\bar{Y}_i$ is the mean income in the income class of individual i. With a possible value of λ, the economic proximity of an income class declines with the difference between the individual's income and the mean income of that class.

The new variable g_i^* is thus a weighted average of others' contributions with weights that are specific to each individual. The equation has been estimated with values of g_i^* corresponding to all integral values of λ between 0 and 15. The sum of squared residuals increases with λ until λ = 10 and then remains constant. This value of λ implies that the weights on all other income classes are so small that the giving by other classes can be ignored;[42] the value of g_i^* is effectively $\ln \bar{G}_i$, the logarithm of the mean giving in the individual's own income class. Moreover, the coefficient of this variable is itself insignificant:

$$\begin{aligned} \ln G_i = -4.82 &+ \underset{(0.14)}{0.84} \ln YPD - \underset{(0.28)}{0.96} \ln P50 \\ &+ \underset{(0.06)}{0.10} \ln W + \underset{(0.24)}{0.22}\, g^* + \underset{(0.21)}{0.15}\, AGE3554 \\ &+ \underset{(0.26)}{0.26}\, AGE5564 + \underset{(0.30)}{0.44}\, AGE65+ \end{aligned} \tag{15}$$

$$R^2 = 0.21 \quad N = 1406 \quad SSR = 9773$$

The point estimate implies that an individual's giving is increased somewhat by the amount of the contributions made by other individuals in his own income class. To evaluate the full effect of the other variables in this model, we must recognize that g_i^* is itself a function of these same variables for the other individuals in income class i. We can approximate the total effects by assuming that all individuals within each class are identical except for age. The values of $\ln G_i$ and g_i^* are then identical for each age class and equation 15 can be solved to yield the price, income, and wealth elasticities. The implied total price elasticity is therefore −1.23, only slightly higher than in the earlier specification.

The essentially negative conclusions implied by equation 15 prompted us to consider an alternative specification. A potential donor might focus on how much others give relative to their income rather than on the absolute amount that they give. We therefore redefine the interdependence variable as

$$g_i^{**} = \frac{\sum_j W_{ij} \ln (\bar{G}_j/\bar{Y}_j)}{\sum_j W_{ij}} \tag{16}$$

where $(\bar{G}_j/\bar{Y}_j)$ is the ratio of mean giving to mean income in income class j. The results with this new specification are very similar to those with g_i^*. The sum of squared residuals again decreases as λ increases until λ = 5 and then increases slightly. The effect of g^{**} is insignificant and the other coefficients are affected very little:

$$\begin{aligned} \ln G = {} & -5.31 + \underset{(0.24)}{0.72} \ln YPD - \underset{(0.27)}{1.01} \ln P50 \\ & + \underset{(0.06)}{0.10} \ln W + \underset{(0.19)}{0.15}\, g^{**} + \underset{(0.21)}{0.15}\, AGE3554 \\ & + \underset{(0.26)}{0.26}\, AGE5564 + \underset{(0.30)}{0.45}\, AGE65+ \end{aligned} \tag{17}$$

$$R^2 = 0.21 \qquad N = 1406 \qquad SSR = 9776$$

The estimates presented in this section thus provide no support for the view that the total amount that an individual contributes is a function of the amount given by others. Although these results are clearly not definitive evidence against the notion of such interdependence among individuals, we believe that the burden of proof now rests with those who support a theory of interdependent giving.

VI

SIMULATED EFFECTS OF ALTERNATIVE TAX CHANGES

This section uses the estimated price and income elasticities to calculate the effects of alternative changes in the income tax treatment of charitable contributions. The simulations show, for each income class, the change in the average gift, the change in the average income tax paid and the resulting change in net disposable income after tax and contributions.[43] It is a perhaps ironic and unintended effect of several of the proposals that although they increase the taxes paid by the higher income groups, they also increase the net disposable income after tax.

Four possible tax changes have been examined. The first alternative is the complete elimination of the deductibility of charitable contributions, that is, raising the price of giving to 1 for all households. The second proposal is to replace the deductibility with a tax credit at the rate of 20 percent, that is, changing the price of giving to 0.8 for all households, including those that do not currently itemize.[44] Note that this is equivalent to a matching scheme in which the donor receives neither a credit nor a deduction but the donee receives a matching grant from the government equal to 25 percent of the total contributions that it receives. The third proposal is also a tax credit but with a rate of 30 percent, or, equivalently, a matching system with a matching rate of 43 percent.

The final alternative is to continue the deduction of charitable contributions but to eliminate the taxpayer's ability to contribute appreciated property without paying any tax on the capital gains. More specifically, this proposal is to tax the donor on the capital gains component of his gift, that is, to make the price of all gifts 1-m where m is the marginal rate of income tax.[45] The importance of this change for each taxpayer obviously depends on that taxpayer's current use of gifts of appreciated property. For the simulations we have treated this proposal as equivalent to changing the price from P50 to 1-m.[46]

Associated with each of these proposals is an across-the-board change in all tax rates designed to keep the tax revenue unchanged. The calculation of this compensatory change and the actual process of simulation can be described most easily for the first proposal. Complete elimination of the deductibility of charitable contributions has two effects: (1) For itemizers, it raises the price of giving from P50 to 1. (2) This yields additional tax revenue to the government equal to $\Sigma_i(1-P50_i)G_i f_i$, where G_i is the amount given by individual i before the change in the tax rate and f_i is the weight to individual i based on the original sampling probabilities.[47] The ratio of this additional tax revenue to the total tax receipts is the factor by which all tax rates can be reduced and leave the government with the same total tax revenue that it had before the elimination of the deduction. This reduction in all tax rates reduces each individual's tax liability and therefore increases his value of "income after the tax that would be due if no contribution were made" (YD and YPD). The resulting change in each individual's contribution is then calculated from the equation:[48]

$$\begin{aligned} \ln G_i' - \ln G_i &= 0.87\,(\ln YPD_i' - \ln YPD_i) \\ &\quad + 1.15 \ln P50_i \end{aligned} \tag{18}$$

where G_i' is the predicted contribution after the tax change and YPD_i is the original value of "permanent income minus the tax that would be due if no contributions were made" plus the value of the tax reduction for individual i. Since eliminating the deduction raises the price of giving to 1, $\ln P50_i' = 0$ and therefore does not appear in equation 18.

The analysis of the effects of a 20 percent tax credit is more complicated. First, each individual's price is changed from P50 to 0.80. If each individual's giving remained unchanged, this would yield additional tax revenue to the government equal in value to $\Sigma_i(1-P50_i-0.20)G_i f_i$. If all tax rates are cut by the ratio of the additional tax revenue to the original revenue, the individual's income increases to YPD$'$. This "trial" value of YPD$'$ is then used to calculate a new gift according to

$$\begin{aligned} \ln G' - \ln G &= 0.87\,(\ln YPD' - \ln YPD) \\ &\quad - 1.15\,(\ln 0.80 - \ln P50) \end{aligned} \tag{19}$$

The new G$'$ values of giving imply a different cost to the government of the tax credit and therefore a different total revenue gain from the tax change: $\Sigma(1-P50-0.20)G'$. The incomes are again adjusted (to YPD$''$) and a new set of gifts (G$''$) are calculated using a specification analogous to equation 19. Although this process might be repeated again, the additional accuracy that could be gained at this stage is too small to warrant the additional computations.

A similar iterative procedure is used to assess the effect of changing the tax treatment of appreciated assets but this time the tax reduction alters the price term as well as the income term. Thus, the first round simulation becomes

$$\begin{aligned} \ln G' - \ln G &= 0.87\,(\ln YPD' - \ln YPD) \\ &\quad -1.15\,[\ln(1-m') - \ln P50] \end{aligned} \tag{20}$$

where m$'$ is the marginal tax rate after the tax cut has been put into effect.

Table 4 presents the predicted effects of the four tax changes on the average contributions per household in each gross income class.[49] Consider first the complete elimination of the deduction. The simulations indicate that this would reduce the average gift (in 1963) from $157 to $116, a reduction of 26 percent.[50] Of course, the relative change differs substantially among income classes. Households with incomes below $5,000, a group that includes many non-itemizers, had an average current price of 0.94. Removing the deductibility of contributions only raises the average price by 6 percent. It is not surprising, therefore, that the average contribution only falls from $59 to $53 or 11 percent.[51] In contrast, households with incomes over $100,000 faced an average price of only 0.14 and would respond to the tax change by cutting their contributions by 95 percent.[52 53]

Table 4

Effects of Alternative Tax Changes on Average Contributions

			Average Charitable Contribution ($)		
Income Class ($000)	Current Law	Eliminate Deduction	20% Tax Credit	30% Tax Credit	Constructive Realization of Asset Gifts
0-5	$ 59	53	60	64	60
5-10	150	126	156	177	158
10-15	193	148	185	211	196
15-20	315	228	284	325	321
20-50	670	381	475	545	684
50-100	2062	767	940	1063	2198
100 +	22528	1173	1380	1521	8029
Average	157	116	141	159	155
			Contributions Relative to Actual 1963 Gifts		
0-5	1.00	0.89	1.02	1.08	1.02
5-10	1.00	0.84	1.04	1.18	1.05
10-15	1.00	0.77	0.96	1.09	1.02
15-20	1.00	0.72	0.90	1.03	1.02
20-50	1.00	0.57	0.71	0.81	1.02
50-100	1.00	0.37	0.46	0.52	1.07
100 +	1.00	0.05	0.06	0.07	0.36
Average	1.00	0.74	0.90	1.01	0.99

The replacement of the deduction by a 20 percent tax credit (including a credit to non-itemizers) only decreases average giving by 10 percent while a 30 percent credit actually increases average giving by 1 percent. This substitution does, however, have a substantial effect on the distribution of contributions among different income classes. A 30 percent credit raises the average gift of households with incomes below $20,000 but decreases the average gift of households with $50,000 to $100,000 by 48 percent and the average gift of households with income over $100,000 by 93 percent. Such a change in the sources of total giving would have an important impact on the distribution of gifts among different types of donees. Religious organizations receive a large share of the gifts of low- and middle-income families while higher income families give primarily to education, health, cultural, and community organizations.[54]

Table 5

Effects of Alternative Tax Changes on Tax Payments and Disposable Income

Income Class ($000)	Eliminate Deduction	20% Tax Credit	30% Tax Credit	Constructive Realization of Asset Gifts
		Tax Ratios		
0-5	0.99	0.98	0.97	1.00
5-10	1.00	0.98	0.97	1.00
10-15	0.99	0.98	0.99	1.00
15-20	0.99	0.99	1.00	1.00
20-50	1.00	1.01	1.02	1.00
50-100	1.01	1.02	1.04	0.99
100 +	1.17	1.19	1.21	1.11
		Net Disposable Income Ratios		
0-5	1.00	1.00	1.00	1.00
5-10	1.00	1.00	1.00	1.00
10-15	1.01	1.00	1.00	1.00
15-20	1.01	1.00	0.98	1.00
20-50	1.01	1.01	1.00	1.00
50-100	1.03	1.01	1.00	1.00
100+	1.12	1.08	1.05	1.10

The tax ratio is the ratio of taxes due under the alternative to 1963 taxes under the current law.

The net disposable income ratio is the corresponding ratio of income minus tax minus contributions.

All ratios are rounded to the nearest 0.01.

Finally, the constructive realization of gifts of appreciated assets causes a substantial reduction (64 percent) in giving in the highest income class and very small increases in all other classes. These increases occur because the tax change and the reduced contribution yield substantial additional tax revenue from the highest income class which permits increasing disposable income in all other classes. These increases in income outweigh the small increases in price. Just as with the introduction of a credit, there is almost no effect on total giving but a large change in the relative importance of different donors and therefore a significant shift in the distribution of total giving among different types of donees.

Table 5 shows the effects of the four tax proposals on the tax paid in each income class and on the net disposable income after both tax and charitable contributions. As in Table 4, each of the changes in the tax treatment of charitable contributions is accompanied by a proportional change in all tax rates to keep current total tax collections unchanged. The tax ratios, that is, the ratio of the taxes under the proposed alternative to current taxes, are all between 0.98 and 1.04 for households with incomes (before tax) of less than $100,000. The only significant changes in tax liability occur for households with incomes over $100,000. The smallest increase in tax liability (11 percent) results from the constructive realization of appreciation in gifts of assets. The largest increase (21 percent) occurs when the current deduction is replaced by a 30 percent tax credit.

The net disposable income ratios show a rather surprising result. Although there is almost no change (less than 3 percent) for households with incomes below $100,000, the highest income households actually have an increase in net disposable income of between 5 and 12 percent. The fall in charitable contributions in this highest income group exceeds the increase in taxes, leaving the households with a greater net income for personal consumption or accumulation.

VII

CONCLUSION

This paper has presented a detailed analysis of the sensitivity of charitable giving to alternative tax treatments. The evidence indicates that the elasticity with respect to the price or net cost of giving is slightly greater than one. This implies that any increase in price will reduce the total contributions received by charitable organizations by more than it increases the taxes collected by the Treasury.

The price and income elasticities estimated in the current study are very similar to the values obtained by Feldstein[55] with a very different type of data: total contributions on itemized returns as reported by the Internal Revenue Service for each adjusted gross income class in the even years from 1948 through 1968. Some preliminary analysis of a yet different type of data, a large sample of individual tax returns for 1962 and 1970, appears to provide further support for these elasticities.

The appropriate tax policy in this area depends on a complex set of issues and value judgments. The key empirical question is the extent to which alternative tax treatments would affect the volume and distribution of charitable contributions. We hope that the current study will provide a useful empirical basis for any future policy analysis.

Acknowledgements

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Footnotes

1. Paul Ginsburg, *Capital in Nonprofit Hospitals*, unpublished Ph.D. thesis, Harvard University, 1970, discusses the analogy between charitable contributions in nonprofit organizations and equity capital in profit-making organizations. The charitable endowment provides the basis on which to borrow and the income with which to subsidize services that receive public support of less than 100 percent. In 1973, philanthropic and religious organizations received $18.2 billion from individual contributions, $3.1 billion from bequests, $0.95 billion from corporations and $2.4 billion from foundations (American Association of Fund-Raising Counsel, 1974).

2. See, for example, the discussions in William D. Andrews, "Personal Deductions in an Ideal Income Tax," *Harvard Law Review*, Vol. 86, No. 2 (December 1972), pp. 309-385;Boris I. Bittker, "The Propriety and Vitality of a Federal Income Tax Deduction for Private Philanthropy." In *Tax Impacts on Philanthropy* (Tax Institute of America publication, 1971); Gerard M. Brannon, "The Effect of Tax Deductibility on the Level of Charitable Contributions and Variations on the Theme," mimeo., 1973; R. Goode, *The Individual Income Tax* (Washington, D.C.: The Brookings Institution, 1964); Harry C. Kahn, *Personal Deductions in the Federal Income Tax* (Princeton: Princeton University Press, 1960); Paul R. McDaniel, "An Alternative to the Federal Income Tax Deduction in Support of Private Philanthropy," In *Tax Impacts on Philanthropy* (Princeton: Tax Institute of America, 1972), pp. 171-209; McDaniel, "Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction," *Tax Law Review*, Vol. 27:3 (Spring 1972), pp. 377-413; Joseph A. Pechman, *Federal Tax Policy* (New York: W.W. Norton & Co., Inc., 1971); Stanley S. Surrey, et al. *Federal Income Taxation* Mineola, N.Y.: The Foundation Press, Inc. 1972); U.S. Treasury Department, Tax Reforms Studies and Proposals, in U.S. Congress, House Ways and Means Committee and Senate Finance Committee, 91st Congress, 1st Session, 1969; William S. Vickrey, "Private Philanthropy and Public Finance," mimeo., 1972; Vickrey, "One Economist's View of Philanthropy." In *Philanthropy and Public Policy*, Frank Dickinson

(ed.), 1962, pp. 31-56; Murray L. Weidenbaum, "A Modest Proposal for Tax Reform," *The Wall Street Journal* (April 4, 1973), p. 18; Melvin I. White, "Proper Income Tax Treatment of Reductions for Personal Expense," *Tax Revision Compendium*, Compendium of Papers on Broadening the Tax Base Submitted to the Committee on Ways and Means, House of Representatives, U.S. Congress (Washington, D.C.: U.S. Government Printing Office), Vol. 1 (1959), pp. 370-371.

3. Michael K. Taussig, "Economic Aspects of the Personal Income Tax Treatment of Charitable Contributions," *National Tax Journal*, Vol. XX, No. 1 (March 1967), pp. 1-19.

4. We are grateful to the Brookings Institution for making available a copy of the 1962 Tax File Tape. Professor Taussig has explained to us that he was aware that his copy of the tape was missing a large number of itemized returns and that he had tried to see if there was anything systematic about the missing observations.

5. These are discussed in Martin Feldstein, "On the Effects of the Income Tax Treatment of Charitable Contributions: Some Preliminary Results," *National Tax Journal* (forthcoming), 1974, and Feldstein and Amy Taylor, "Taxation and Charitable Contributions: An Analysis of Individual Tax Return Data for 1962 and 1970," forthcoming, 1974.

6. The results of this reanalysis are described in Feldstein and Taylor, op. cit.

7. Robert A. Schwartz, "Personal Philanthropic Contributions," *Journal of Political Economy*, Vol. 78:6 November/December 1970), pp. 1264-1291.

8. Feldstein, "On the Effects of the Income Tax Treatment of Charitable Contributions: Some Preliminary Results," op. cit.

9. Ibid.

10. Dorothy S. Projector, and Gertrude S. Weiss, *Survey of Financial Characteristics of Consumers* (Washington: Board of Governors of the Federal Reserve System, August 1966).

11. The value of $1,721 represents the 20th percentile of adjusted gross income. These households were excluded to eliminate observations in which current income was very different from permanent income. Other methods of dealing with this problem are described below.

12. No information or actual itemized giving is published for odd-numbered years.

13. The difference may also reflect the methods of valuing gifts for tax purposes and errors in the division of the sample into itemizers and nonitemizers. Although we used all of the available observations in this calculation (not just the 1,406 observations used in the regression), households that refused to tell how much they gave were treated as giving zero; these households were excluded in the regression sample.

14. The usual measure of disposable income, i.e., income minus taxes *actually* paid, is endogenous because such taxes depend on the amount of charitable contributions. This is unimportant for low-income individuals and for aggregate data but could matter with the current sample.

15. YD62 is converted into 1963 dollars by the consumer price index. The value of YD62 cannot be calculated as accurately as the value for 1963 because the tax for 1962 must be approximated on the basis of 1963 data by assuming the same average tax rates.

16. It would be interesting to try alternative definitions of this annuity, including the use of a human wealth measure, allowing for social security benefits, income for the surviving spouse, etc.

17. Since ln V is uncorrelated with ln U, this is a consistent procedure. A more efficient method could be developed by extending this along the lines suggested by A. Zellner, *An Introduction to Bayesian Inference in Econometrics* (New York: John Wiley & Sons, 1971) and A.S. Goldberger, "Maximum-Likelihood Estimation of Regressions Containing Unobservable Independent Variables," *International Economic Review*, 13:1 February 1972), 1-15.

18. The definition of consumption used by Projector and Weiss, op. cit., is inconsistent; it includes *cash* contributions but not gifts of assets. It therefore underestimates consumption relatively more for high-income households. We also estimated with consumption defined net of contributions; the two sets of coefficients are very similar.

19. A deduction is not allowed for contributions exceeding 30 percent of adjusted gross income, but any excess can be carried forward. The limit affects extremely few individuals, especially after the carryover is taken into account. No attempt was made to take this into account.

20. Since income of the donee organization is not taxable, it can sell the appreciated asset without paying any tax.

21. If the individual gives the asset away to another person, there is no constructive realization and the tax is postponed until the recipient sells the asset. The original owner can also consume most of the value of the asset by using it as collateral to borrow funds which he then consumes, thus enjoying the consumption while postponing or avoiding the capital gains tax. See Martin J. Bailey, "Capital Gains and Income Taxation," In A.C. Harberger and M.J. Bailey (eds.) *The Taxation of Income from Capital* (Washington, D.C.: The Brookings Institution, 1969); for evidence that a very large share of accrued capital gains are never subject to capital gains taxation.

22. Using weights based on the household's own contributions would be inappropriate because it would make the price variable a function of contributions.

23. These items of taxable income refer to the husband and wife but exclude income of other family members. Unfortunately, the data on contributions is for the entire family. We can assume that the difference is likely to be small. The estimates reported below actually use pretax income and wealth of the entire family but tax variables based on the husband and wife. We have also reestimated equations using pretax income of the husband and wife only and obtained virtually the same results.

24. The classification actually finds whether they would or would not itemize in the absence of charitable contributions. This is in keeping with our definitions of price and disposable income.

25. This is intended to reflect the deductible mortgage interest on the owner's equity plus the local property tax.

26. Together with the 5 percent of the value of owned residences, the percentages of AGI are intended to estimate all itemized deductions other than charitable contributions (including interest, medical expenses, state and local taxes). A search procedure was used to find the percentages, within each broad AGI class, which made the weighted proportion of taxpayers who itemized in the sample equal to the actual proportion of returns which were itemized in 1963. These percentages are for all itemized returns, not just those that would have itemized if there were no deduction for contributions.

27. The calculation ignores state income taxes. There is no information on the taxpayer's state of residence. These rates were generally still quite low in 1963.

28. The correlation between $1-m$ and $1-m-mc(1-B/V)\alpha$ would be 1 if mc were proportional to m. In fact, $mc = 0.5\,m$ for *all* taxpayers with marginal rates below 0.50 and $mc = 0.25$ for *all* other taxpayers. Fon non-itemizers, both prices are 1.

29. Other forms of liquid assets do not in general appreciate. Bond prices were generally falling in the period before 1963. Although gifts of real estate, works of art and other property are possible, these are relatively uncommon and are unlikely for individuals who do not hold common stock. Our analysis takes no account of gifts of "income property," e.g., personal papers and artists' own creations.

30. The 3 percent is arbitrary but conservatively small. A comparison of the sum of squared residuals with and without this qualifying test shows that the test improves the explanatory power of the model.

31. This, of course, assumes that the disturbances are normal, independent and homoskedastic.

32. More exactly, $(1.19)^{-1.15} = 0.82$, implying that contributions are decreased by 18 percent or $30.

33. This has been stressed by Henry Aaron, "Federal Encouragement on Private Giving," in *Tax Impacts of Philanthropy*, Symposium conducted by Tax Institute of America (Princeton, N.J.: Tax Institute of America, 1972), Kahn, op. cit., McDaniel, "An Alternative to the Federal Income Tax Deduction in Support of Private Philanthropy," op. cit., and Vickrey (1962), op. cit., among others. Although the effect on the average gift is small, the aggregate effect is substantial. We return to this in Chapter IV below.

34. Feldstein, "On the Effects of. . .," op. cit. These aggregate equations defined income as adjusted gross income and did not contain wealth or age variables. The maximum likelihood price variable also assumes a basis to value ratio of 0.50.

35. Eli Schwartz, and J.R. Aaronson, "The Preference for Accumulation vs. Spending: Gifford Estate Taxation, and the Timing of Wealth Transfers," *National Tax Journal,* 22:3 (September 1969), pp. 390-398; Feldstein, "Estate Taxation and Charitable Bequests," forthcoming, 1974, and Carl Shoup, *Federal Estate and Gift Taxes* (Washington, D.C.: The Brookings Institution, 1966.) on the effects of taxation on charitable bequests.

36. This group contains some who are completely retired and others who have reduced their work without being completely retired. Because it is not possible to distinguish the "partly retired" from those who are fully employed, we focus on age alone.

37. For the complete sample, the sum of squared residuals is 9792 while for the two subsamples it totals 9760. The F statistic is 0.91, less than the 5 percent critical value of 2.21 with 5 and 1394 degrees of freedom. The price elasticity for those below age 60 is -1.43 with a standard error of 0.27.

38. These are weighted averages in which the relative weight is the inverse of the sampling probability for the household.

39. For example, a wealthy aged individual may prefer to forego the income tax deduction and make a charitable bequest because this increases the size of his gross estate and therefore the amount that can be given free of estate tax to his wife under the 50 percent marital deduction.

40. Dennis L. Krebs, "Altruism — An Examination of the Concept and a Review of the Literature." *Psycological Bulletin,* Vol. 73:4 (1970), pp. 258-302.

41. The specification of g^* uses 7 income classes with lower limits of zero; $5000; $10,000; $15,000; $25,000; $50,000; and $100,000.

42. Only the values for income class i matters because of the high value of λ. With $\lambda = 10$, the relative weight to giving in other classes is always less than 0.006.

43. No attempt is made to calculate the effect on total giving because the simulations are done with the same restricted sample of 1,406 households as the original regressions.

44. I ignore the possibility that some households pay no taxes and cannot benefit from a tax credit. Alternatively, the proposal might be regarded as paying a cash subsidy to any household in which the credit exceeds the tax liability.

45. Non-itemizers would be unaffected by this proposal and would continue to face a price of 1.

46. Recall that P50 for household i is equal to

$$W_i[1-m_i] + (1-W_i)[1-m_i-0.50\ mc_i]$$

where W_i is the ratio of cash gifts to total gifts for households in that income class, m_i is the marginal rate of tax on income and mc_i is the marginal rate of tax for capital gains. See Chapter II above.

47. If the entire sample were used, $\Sigma_i f_i$ would equal the total number of households. All of the current calculations are based on Σf_i for the restricted group of 1,406 households.

48. The parameter values are taken from equation 6. Recall that G_i is one dollar more than the contribution actually reported by the individual. Note that the age variables, wealth variables, and constant terms can be ignored because the equation calculates only the relative change in each individual gift.

49. The income classes are defined in terms of total income before tax.

50. Because these averages include the gifts of both itemizers and non-itemizers, the reduction of 26 percent is necessarily smaller than the 34 percent reduction for itemizers only that was previously reported in Feldstein, "on the effects of. . .," op. cit. For non-itemizers, this proposal raises giving since price is unchanged while income rises.

51. It might seem at first that contributions should fall even less since a 6 percent price increase and a price elasticity of −1.15 imply a fall of only 7 percent which the tax cut, by raising incomes, partly offsets. But the relevant price change is not the unweighted average but the weighted average in which the weights are the original amounts of the contribution. Since lower original prices are associated with larger original contributions, the weighted average effect is larger than the unweighted effect.

52. An increase in price from 0.14 to 1.00 would in itself cut giving by 90 percent. But, as the previous note indicated, the negative correlation between original price and original giving implies that this underestimates the effect of the tax charge.

53. This represents a substantially greater change than the 78 percent decrease calculated in Feldstein, "On the Effects of. . .," op. cit., because that calculation made no allowance for the effect of gifts of appreciated assets. Although the average price for this group is P50=0.14, the average price of cash gifts is 0.22.

54. See Feldstein, "Taxes and Charitable Contributions: Differences in the Impact of Alternative Tax Policies on Religious, Educational and Other Organizations," mimeo, 1974.

55. Feldstein, "On the Effects of. . .," op. cit.

THE INCOME TAX AND CHARITABLE CONTRIBUTIONS: ESTIMATES AND SIMULATIONS WITH THE TREASURY TAX FILES

Martin S. Feldstein[†] and Amy Taylor[*]

Introduction

This paper presents new evidence on the price and income elasticities of charitable giving based on the special Treasury tax files for 1962 and 1970. These data sets provide very large samples of individual observations with exact information on the tax price and charitable giving. The basic parameter estimates are very similar to earlier results that were obtained using aggregate pooled cross-section time-series data[1] and household survey data.[2] The parameter estimates are used here with the 1970 Treasury Tax File to simulate the effects of several possible alternatives to the current tax treatment of charitable giving.

Chapter I describes the basic specification and data that are used to derive the estimates. Chapter II presents parameter estimates for 1962 and 1970 using different definitions of the key variables. Chapter III combines data for 1962 and 1970, thus using the historical change in tax rates as the basis for estimating the price elasticity. The fourth chapter discusses the evidence on separate elasticities by income class. The simulation method and results are presented in Chapter V. There is a brief concluding section.

I

SPECIFICATION AND DATA

Because charitable contributions are deductible in determining taxable income, the current income tax system makes the "price" of charitable contributions less than the price of other goods and services. An individual with a marginal tax rate of 40 percent can give $100 to charity by foregoing $60 of personal consumption; for him the net price of charitable contributions is only 0.6. More generally, for an individual whose marginal tax rate is m the price of charitable giving is P = 1-m. (When the contribution includes a gift of appreciated property, the price is lower and more complicated to compute. We return to this below.)

The basic specification of the behavioral equation relating charitable giving (G) to income (Y) and price (P) is the constant elasticity relation:

$$\begin{aligned} \log G_i = \beta_0 + \beta_1 \log Y_i + \beta_2 \log P_i \\ + \beta_3 \text{MAR}_i + \beta_4 \text{AGE}_i + \epsilon_i \end{aligned} \qquad (1.1)$$

where MAR_i is a dummy variable indicating that the taxpayer is married and AGE_i is a dummy variable indicating whether the taxpayer was over age 65. The primary definition of income that is used in this study is adjusted gross income minus the tax that would have been paid if no charitable contribution were made. The marginal tax rate is based on the corresponding taxable income, that is, the taxable income of the individual if no charitable contribution were made. In this way, the income and price variables are exogenous, at least to the extent of not depending on the individual's charitable giving. (Other measures of price and income have been studied and will be discussed below.)

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The 1970 Treasury Tax File is a sample of individual tax returns for the year 1970. These returns are a stratified random sample of all returns for that year with a sampling fraction that increases with income until there is 100 percent sample for incomes over $200,000. To limit the computational costs of analyzing these data, we drew a 20 percent random sample from the tax file. After eliminating the returns of non-itemizers, the sample contained 15,291 returns.

As we indicated above, the price variable depends on the marginal tax rate for the taxable income that the individual would have had if he had made no charitable gift. For most taxpayers this was calculated easily by adding actual charitable giving to actual taxable income and using the tax tables to find the marginal rate on this expanded taxable income. Special calculations were made for taxpayers who used income averaging or the alternative tax method. The Treasury assisted us by adding the state marginal income tax to each record, together with an indication of whether federal taxes are deductible in computing state taxable income. Each individual's total marginal tax rate was calculated by combining state and federal marginal tax rates, with full allowance for the reciprocal deductions where appropriate.

Contributions of appreciated assets create a special problem for measuring the price of charitable giving. When an asset is given away, its full value can be deducted from the donor's taxable income but there is no constructive realization and therefore no tax to be paid by the donor on the capital gain. The opportunity cost (price) of a gift that is given in the form of an appreciated asset therefore depends not only on the individual's marginal tax rate but also on the fraction of the asset's value that is accrued capital gain and on the alternative disposition of the asset. An example will clarify the way in which these variables determine the relevant price. Consider an individual whose marginal rate is 40 percent and who contemplates donating an asset that is now worth $100 and for which he originally paid $30. If he gives the asset away, he reduces his taxable income by $100; he therefore reduces his tax liability by $40 and thus increases his after-tax income by $40. If he instead sells the asset, he pays a tax of $14 (half of his marginal rate on the capital gain of $70) and increases his after-tax income by $86. For this individual, the opportunity cost of the $100 contribution is therefore $46 of foregone consumption. If the price is defined in terms of foregone consumption, the price of the gift is $P = 0.46$. This price clearly depends on the ratio of the asset's original cost (or basis) to its current value: an original cost of $1 imples $P = 0.40$ while an original cost of $100 implies $P = 0.60$. More generally, $P = 1 - mc(1 - B/V) - m$ where V is the current value of the asset, B is its basis or original cost, m is the marginal tax rate on income and mc is the marginal tax rate on capital gains.

The preceding calculation defined the opportunity cost of a donated asset in terms of foregone immediate consumption, that is, it assumed that if the asset were not given away it would be sold in the current year. The price is higher and the calculation is more complex if the opportunity cost is defined in terms of foregone saving or wealth, that is, if it is assumed that the asset would not otherwise be sold in the current year. The individual in the preceding example could retain the $100 asset or he could give it away and add the $40 tax saving to his wealth. Viewed in this way, his opportunity cost price is 0.60, the same as for contributions of money; moreover, this price is independent of the ratio of the capital gain to the present asset value. Since the individual who does not give away the asset also has a future tax liability, this tends to overstate the opportunity cost of a prospective contribution. However, by postponing the sale of the asset the individual can substantially lower the present value of the tax, and if the asset is never sold during the individual's lifetime, the capital gains tax liability is completely eliminated when the asset passes at death.[3]

If we denote the present value of the reduction in the capital gains tax by $\alpha\, mc(1-B/V)$ where $0 \leqslant \alpha \leqslant 1$ is the relevant discount factor, the price of a gift of appreciated property is $1-m-\alpha \cdot mc \cdot (1-B/V)$. Since neither α nor B/V is known and since only their product enters the price variable, we have used a maximum likelihood search procedure (described below) to estimate the composite parameter $\alpha(1-B/V)$. The value of $\alpha(1-B/V)$ is assumed to be the same for all taxpayers.

For any given value of $\alpha(1-B/V)$ there is still a problem of how to combine the separate price variables for gifts of cash and for gifts of appreciated property. Although the price for gifts of property is always less than the price for cash gifts, individuals who make gifts of property almost always also make gifts of cash. These individuals may prefer cash gifts for contributions below some minimal size or for contributions to particular types of donees. Since there is very high correlation between the two prices,[4] it is better to use a weighted average of the two prices than to use the two prices separately. The relative importance of the two prices clearly differs among the income classes: the data indicate that gifts of assets accounted for less than 1 percent of total giving by households with income below \$15,000 but for more than 60 percent of total giving by households with income over \$100,000. Although weights could be assigned to each taxpayer on the basis of the composition of that taxpayer's gifts, doing so would introduce a very substantial element of inappropriate simultaneity in the definition of price. Instead, households are classified into seven income classes with the relative weights for all households in each class based on the average composition of the gifts in that class.

Not all taxpayers can take advantage of the option to contribute appreciated property. An individual who does not own common stock is unlikely to have an appreciated asset that is suitable for making charitable gifts. As a precautionary measure, we assume that any taxpayer who does not report dividends or capital gains will make only cash gifts.

The final price variable will be written $P[\alpha(1-B/V)]$ to emphasize that it is conditional on the parameter $\alpha(1-B/V)$. The variable is defined by:

$$P[\alpha(1-B/V)]_i = 1-m_i \text{ for taxpayers with insufficient common stock}$$

$$= W_i(1-m_i) + (1-W_i)\,[1-m_i-\alpha(1-B/V)mc_i] \qquad (1.2)$$

for others

where the weight W_i is the ratio of the value of cash gifts to total gifts for the income class of which household i is a member. For alternative values of $\alpha(1-B/V)$ between zero and one, the logarithm of $P[\alpha(1-B/V)]_i$ is substituted for $\ln P_i$ in the basic specification of equation 1.1. The value of $\alpha(1-B/V)$ for which the regression has the lowest sum of squared residuals is the maximum likelihood estimate of this composite parameter and the estimated coefficients for this value are the maximum likelihood estimates of the corresponding parameters.

The Treasury Tax File for 1962 is very similar to the 1970 File.[5] The 20 percent random sample of itemized returns provided 13,770 observations. The primary difference in procedure is that the marginal tax rate refers only to the federal tax rate since no information on state rates was available.

II

THE BASIC CROSS-SECTION ESTIMATES

The estimate of the basic equation with data for 1970 is presented in equation 2.1

$$\begin{array}{llll} \ln G = -1.419 \ln P & + 0.768 \ln Y & + 0.317 \text{ MAR} & \\ \quad\;\; (0.070) & \quad (0.023) & \quad (0.048) & \\[1em] \quad + 0.443 \text{ AGE} & - 2.580 & & (2.1) \\ \quad\;\; (0.038) & \quad (0.201) & & \\[1em] & & R^2 = .404 & \\ & & \quad 1970 & \end{array}$$

The price elasticity is -1.419 and the income elasticity is 0.768. In spite of the potential problem of collinearity between price and income, the standard errors are very small. The coefficient of the dummy variable for married taxpayers (0.317) indicates that married couples give 32 percent more than single individuals with the same income and price. The coefficient of the age dummy indicates that taxpaying units in which one or both of the taxpayers is over 65 years old give 44 percent more than younger taxpayers with the same income and wealth.

Equation 2.2 shows that the price and income elasticities for 1962 are very similar to those for 1970:

$$\begin{array}{llll} \ln G = -1.305 \ln P & + 0.745 \ln Y & + 0.265 \text{ MAR} & \\ \quad\;\; (0.036) & \quad (0.018) & \quad (0.042) & \\[1em] \quad + 0.132 \text{ AGE} & - 2.100 & & (2.2) \\ \quad\;\; (0.034) & \quad (0.160) & & \\[1em] & & R^2 = 0.52 & \\ & & \quad 1962 & \end{array}$$

The elasticity estimates are also very similar when the sample is restricted to married taxpayers below age 65:

$$\begin{array}{llll} \ln G = -1.274 \ln P & + 0.799 \ln Y & - 2.351 & \\ \quad\;\; (0.043) & \quad (0.020) & \quad (0.176) & \\ & & R^2 = 0.52 & (2.3) \\ & & \quad 1962 & \end{array}$$

The special problems raised by gifts of appreciated property were briefly discussed in Chapter I. As we noted there, the available data severely limit the possibility of dealing fully with this problem. It is necessary to summarize both the effects of allowing the contribution of property at market value without constructive realization for capital gains taxation and the possibility of alternative untaxed dispositions through personal gift or bequest by a single measure of the "discounted gain to value ratio." Since no data are available on the actual gain to value ratio of contributed assets or the alternative way in which the asset would otherwise have been used, a maximum likelihood search over possible discounted gain to value ratios is employed. The sum of squared residuals changes very little (less than 1 percent) as the discounted gain to value ratio varies between zero (where asset gifts are equivalent to cash gifts) and one (where asset gifts are all appreciation and have no basis. (In 1962, at the very highest marginal tax rates, individuals could face a negative price for gifts of appreciated property if the discounted gain to value ratio was sufficiently high. We imposed a lower bound of 0.10 on the price variable for the current estimates.) The minimum occurs at 0.875 in 1970 and at zero in 1962. Neither of these extreme values seems plausible. Although the assets given away may have an actual ratio of gain to value near 0.875, sophisticated taxpayers are aware of the alternative opportunities for avoiding capital gains taxation. The discounted gain to value ratio is therefore almost certainly lower than 0.875. But a value of zero implies that there is no incentive to give assets instead of cash and thus conflicts with the substantial proportion of the gifts of high-income individuals in the form of appreciated assets. Moreover, the two previous studies of this question[6] both found that the maximum likelihood estimate was a discounted gain to value ratio of 0.50. Imposing this value with the current data implies the followng equation for 1970:[7]

$$
\begin{aligned}
\ln G = {} & \underset{(0.059)}{-1.285} \ln P(50) + \underset{(0.024)}{0.702} \ln Y + \underset{(0.048)}{0.341}\, MAR \\
& + \underset{(0.038)}{0.419}\, AGE - \underset{(0.214)}{1.933} \qquad\qquad (2.4) \\
& \qquad\qquad\qquad R^2 = .406 \\
& \qquad\qquad\qquad\ 1970
\end{aligned}
$$

Using this price variable for appreciated asset gifts does not alter any of the basic implications of equations 2.1 and 2.2. The price elasticity of -1.285 is slightly lower than the previous estimate but still implies substantial price sensitivity.[8] The estimates for 1962, shown in equation 2.5, are also quite similar to equation 2.4:

$$
\begin{aligned}
\ln G = {} & \underset{(0.033)}{-1.088} \ln P(50) - \underset{(0.185)}{0.757} \ln Y + \underset{(0.042)}{0.184}\, MAR \\
& + \underset{(0.035)}{0.134}\, AGE - \underset{(0.166)}{2.066} \qquad\qquad (2.5) \\
& \qquad\qquad\qquad R^2 = 0.52 \\
& \qquad\qquad\qquad\ 1962
\end{aligned}
$$

Before studying any further modifications of this equation, it is useful to consider the implications of this estimate of the price elasticity. Among families with disposable incomes between $10,000 and $15,000 in 1970, the average price of giving was 0.80 and the average gift was about $300. If contributions were not deductible, the price would rise by 25 percent (from 0.80 to 1.00) and therefore, given a price elasticity of -1.285, contributions would fall by about 25 percent or $75.[9] This amount is neither implausible nor contrary to the common assertion that the deductibility of contributions is likely to have only a "small" effect on the amount given by lower income households.[10]

For households with disposable income between $50,000 and $100,000, the average contribution was $2,000 and the average price was 0.42. The lower average price in this income class implies that the deductibility of charitable gifts has a substantially greater effect than in the lower income class. Eliminating the deductibility would raise the price by 138 percent (from 0.42 to 1.00) and would therefore lower contributions by about 67 percent or $1,344.

It is interesting to note the special implication of a price elasticity of exactly minus one. With this price elasticity, the value of giving responds to changes in price in such a way that the *net* cost to the individual donor is unaffected by the deductibility. Donees receive an amount equal to the sum of the net cost to the donors (which remains constant) plus the revenue foregone by the Treasury. The efficiency of the incentive to charitable giving, that is, the ratio of additional funds received by donees to revenue foregone by the Treasury, is 100 percent. The actual estimated price elasticity of -1.285 implies an efficiency greater than 100 percent, that is, philanthropic organizations receive more in additional funds than the Treasury loses in foregone revenue.

The current parameter values are very similar to those obtained in earlier studies with very different bodies of data. Feldstein[11] used aggregate Internal Revenue Service data by income class for the years 1948 through 1968. With the same price and income definitions as in equations 2.4 and 2.5, the aggregate analysis implied a price elasticity of -1.17 (S.E. = 0.09) and an income elasticity of 0.82 (S.E. = 0.03). Feldstein and Clotfelter[12] analyzed household survey data collected for the Federal Reserve Board in 1963. The corresponding price and income elasticities are -1.15 (S.E. = 0.20) and 0.87 (S.E. = 0.14).

The implications of this research stand in sharp contrast to the results of an earlier and often cited study by Taussig.[13] Taussig examined a sample of 47,678 itemized individual income tax returns for 1962. He found extremely low price elasticities (absolute elasticities not greater than 0.10) and concluded that the current tax deductibility of contributions therefore does little to stimulate charitable giving.[14] We believe that the basic reason for this striking difference in results is that Taussig used inappropriate measures of price and income. More specifically, Taussig used the marginal rate for actual taxable income, that is, income net of the individual's own charitable contribution. An individual who gives more to charity therefore has, *ceteris paribus*, a lower marginal rate and a higher price. This introduces a spurious positive association of price and giving and thus biases the elasticity with respect to price (or marginal rate) toward zero. Taussig's measure of income was also inappropriately dependent on the individual's actual contribution, that is, income was also measured net of taxes actually paid rather than of the taxes that would have been paid with no charitable contribution. Equation 2.6 shows the results of using this inappropriate measure of price (PT) and income (YT) with our 1962 Treasury Tax File sample of married taxpayers less than 65 years old:

$$\begin{array}{l} \ln G = \underset{(0.045)}{-0.520} \ln PT + \underset{(0.019)}{1.053} \ln YT - \underset{(0.166)}{4.734} \\ \qquad\qquad\qquad\qquad\qquad R^2 = 0.51 \\ \qquad\qquad\qquad\qquad\qquad\ \ 1962 \end{array} \qquad (2.6)$$

The price elasticity of -0.520 is very much lower than the value of -1.274 obtained in equation 2.[illegible] with the more appropriate measure of price. Taussig's use of incorrectly dependent price and income variables thus accounts for more than two thirds of the difference between our estimate and Taussig's earlier result. It is not clear to us why Taussig's estimated price elasticity was actually smaller than the value we obtained in equation 2.6.[15] One possibility is a problem with Taussig's data. Taussig's sample of 47,678 itemized returns was part of the 1962 Treasury Tax File used in the current study. Unfortunately, part of the original data tape containing 22,918 returns (33 percent of the total sample of itemizers) was missing in the computer tapes with which Taussig worked. The frequency distribution of the Taussig sample by income class and other attributes[16] are quite different from those for the complete sample. If Taussig's observations were a random sample from the Tax File, this loss of data should not affect the expected value of the estimates. It is worth noting, however,- that with this incorrect definition of price and income the results are quite sensitive to the particular sample. When equation 2.5 is re-estimated with the 1970 sample, the estimated price elasticity is actually a small but insignificant positive value: 0.025 with a standard error of 0.079. It should be remembered in contrast that equations 2.1 through 2.4 show that the 1962 and 1970 results agree quite well with each other when the correct measures of price and income are used.

III

THE EFFECTS OF CHANGES IN TAX RATES

The basic problem in estimating the impact of taxation on charitable giving is to separate the effects of price and income. Since price depends on marginal rate and marginal rate depends on income, there is a correlation between price and income. The relatively small standard errors of the price and income elasticities in the equations of Chapter II show that the traditional problem of collinearity is not serious in the current context. It is possible, however, that there is a more fundamental problem of under-identification. Suppose that the true relation between giving and income is not one of constant elasticity but involves a more general functional relation. Although the logarithm of price has a low correlation with the logarithm of income, it might have a high correlation with the "correct" function of income. The attempt to estimate this correct functional specification would then lead to very imprecise estimates of the price elasticity.

We do not believe that this is a serious problem. The bivariate distribution of price and income in Table 1 shows that there is substantial variation of price within individual income classes. Nevertheless, we have developed an alternative to the cross-section regression that permits price elasticities to be estimated without any restrictive assumption on the effect of income on giving.

The new method utilizes the fact that tax rates were substantially reduced in 1964. At each real income level, the price of charitable giving in 1970 was higher than the price in 1962. The average charitable contribution at each income level was also lower in 1970 than in 1962. A separate price elasticity could be calculated for each income class if we could be confident that no exogenous factor was responsible for any change in giving. This restrictive assumption is unnecessary if we wish to calculate a common price elasticity for all income levels. We shall allow for an exogenous "trend" factor that raises or lowers giving at all income levels by a common factor and then estimate the price elasticity in a way that involves no assumptions about the effect of income.

Table 2 shows the changes in the price and amount of giving between 1962 and 1970. More specifically, column 1 indicates the 1962 net income class (adjusted gross income minus tax liability with no charitable contributions) and column 2 shows the real income in 1970 corresponding to the midpoint of that class. Column 3 shows the ratio of contributions to net income for taxpayers who itemized in each income class in 1962 (g62) and column 4 shows the corresponding value at the 1970 income level (g70). The estimate for 1970 is obtained by interpolating from a list of ratios similar to column 3 that was derived with the 1970 Treasury Tax File. It is clear that in every case (except the class with incomes over $750,000 in 1962) the value of charitable gifts declined between 1962 and 1970; the ratio of g70 to g62 is presented in column 5. Columns 6 through 8 present the corresponding information about the price for cash gifts. In every case (again except the class with incomes over $750,000 in 1962) the price was higher in 1970 than in 1962.

The change in price and corresponding change in giving can in principle be used to calculate price elasticities for each income class on the assumption that the change in giving is due only to the change in price. That is

$$\left(\frac{g70}{g62}\right)_k = \left(\frac{p70}{p62}\right)_k^{\eta_k} \tag{3.1}$$

where the subscript k denotes the k-th income class. The results of this calculation are shown in column 9. The price elasticities decrease rapidly until the $20,000 income level and then vary between 1.1 and 2.7.

The very high elasticities in the first three income classes are associated with very small price changes. This suggests that there was a systematic exogenous fall in giving in addition to the price effect.

To estimate both the price effect and the exogenous change, we replace equation 3.1 by

$$\left(\frac{g70}{g62}\right)_k = C \cdot \left(\frac{p70}{p62}\right)_k^{\eta} \cdot \epsilon_k \qquad (3.2)$$

where C is a constant (presumably less than 1) and ϵ_k is an independent random variable.

After a logarithmic transformation, the estimated equation is:

$$\ln\left(\frac{g70}{g62}\right) = \underset{(.040)}{-.083} - \underset{(0.214)}{1.540} \ln (p70/p62) \qquad (3.3)$$

$$\bar{R}^2 = .77$$
$$N = 16$$

The price elasticity of −1.540 is very similar to the price elasticities estimated for individual cross-section data for 1962 and 1970. The constant term of −0.083 implies that there was an exogenous decrease of 8 percent from 1962 to 1970 or approximately 1 percent per year.

A similar calculation can be done with the price variable measured to include the effects of appreciated asset gifts. Columns 10 through 12 compare the price based on a 50 percent "discounted gain to value ratio." The estimated response to the change in this price is:

$$\ln (g70/g62) = \underset{(0.033)}{-0.143} - \underset{(0.189)}{1.393} \ln \left[\frac{p(50)70}{p(50)62}\right] \qquad (3.4)$$

$$\bar{R}^2 = 0.78$$
$$N = 16$$

The price elasticity of −1.39 corresponds well to the cross-section estimates of −1.28 for 1970 and −1.09 for 1962.

There is a potential problem with the data for the lower income classes. The fraction of individuals itemizing at each income level below $20,000 decreased between 1962 and 1970. There is a danger therefore of comparing dissimilar households in these income groups. Fortunately, the estimated price elasticity is quite insensitive to the exclusion of the bottom three income groups: the estimated price elasticity changes only from −1.393 to −1.344.

These estimates give equal weight to each of the income classes. However, each observation represents a different number of individual tax returns in our sample. Fortunately, the estimates are not sensitive to weighting the observations. With each observation weighted by the number of individual returns in that class, the price elasticity rises from −1.393 to −1.575.

In short, the method of this section provides strong evidence that there is no identification problem in the cross-section estimates. The current methods literally hold income constant in relating the change in giving to the change in price. The results strongly confirm the cross-section estimates of price elasticities between −1.0 and −1.5.

IV

ESTIMATING SEPARATE PRICE ELASTICITIES BY INCOME CLASS

The assumption that there is a single price elasticity for the entire population is clearly a simplification. Individuals will of course differ in their sensitivity to price. Using a single "average" price elasticity to describe everyone's behavior is nevertheless appropriate if these differences in price elasticity are distributed randomly in the population. But if the "average" price elasticity differs substantially among income classes, it would be inappropriate to simulate economic policies on the assumption of a single constant elasticity.

It is worthwhile, therefore, to examine whether price elasticity does vary with income. There are several ways to do this. The simplest method is to extend the current specification by allowing an interaction term, the product of the logarithm of price and the logarithm of income. This allows the price elasticity to vary continuously with income but forces the variation to assume a smooth and monotonic form with the same relative senstivity to income changes at all levels. The results of such a specification with the 1970 data are presented in equation 4.1:

$$\begin{aligned} \ln G = {} & \underset{(0.475)}{5.351} \ln P + \underset{(0.031)}{0.519} \ln Y \\ & - \underset{(0.042)}{0.602} \ln Y \cdot \ln P + \underset{(0.049)}{0.307}\, MAR \\ & + \underset{(0.038)}{0.395}\, AGE + \underset{(0.306)}{0.114} \end{aligned} \qquad (4.1)$$

$$\bar{R}^2 = 0.406$$

1970

The coefficient of the cross-product term implies that the absolute price elasticity rises substantially with income. Indeed, for incomes below $7,455 the implied price elasticity has the wrong sign. This indicates that the attempt to fit such a smooth and monotonic relation between price and income is not appropriate. In order to fit the observations well at high income levels, the functional form is forced to be inappropriate at low levels.

A more general specification allows the price elasticity to vary among income classes and imposes no particular parametric form on the relation between income and price elasticity. There are two ways in which this can be done. A separate equation can be estimated for each income class, thus allowing not only the price elasticity but also the income elasticity and the effects of marital status and age to vary by income class. Alternatively, a single regression can be estimated with a separate price elasticity by income class but a common income elasticity and common effects of marital status and age. Both methods have been used.

Table 3 presents the estimated price and income elasticities in four income classes when all coefficients are allowed to vary. For incomes above $20,000, the results in both years are similar to the constant elasticity regressions of equations 2.4 and 2.5. There is some indication that the price elasticity increases with income but, except for the highest income class in 1970, the differences are relatively small. The results for taxpayers with incomes below $20,000 differ substantially from the basic constant elasticity regressions. The results also differ greatly between 1962 and 1970. The estimate for 1962 is −3.67 with a standard error of 0.45. In contrast, the 1970 estimate is only −0.35 with a standard error of 0.52. Both of these estimates require further comment.

Table 3

Price and Income Elasticities by Income Class*

Income Class ($000's)	1962 Price P(50)	1962 Income Y	1970 Price (P(50))	1970 Income Y
4-20	-3.67 (0.45)	0.53 (0.07)	-0.35 (0.52)	0.80 (0.10)
20-50	-0.97 (0.26)	0.61 (0.19)	-0.85 (0.31)	0.89 (0.16)
50-100	-1.10 (0.19)	1.90 (0.20)	-1.12 (0.22)	0.87 (0.20)
100+	-1.29 (0.04)	1.02 (0.04)	-1.74 (0.08)	1.03 (0.04)
All	-1.09 (0.03)	0.76 (0.19)	-1.28 (0.06)	0.70 (0.02)

*Based on separate regressions for each income class with dummy variables for martial status and age. Price is based on a discounted gain to value ratio of 0.50.

Consider first the high price elasticity for 1962. This value is not very different from the low income price elasticity estimated previously with the Federal Reserve Board survey data for 1962: -2.50 with a standard error of 0.91.[17] It should be remembered also that this price elasticity reflects a response to a relatively small price differential among lower-income households. The vast majority of households with incomes under $20,000 faced a price of 0.8 or greater. Eliminating the deduction would therefore raise their price by less than 25 percent. Even with a price elasticity of -3 this would reduce their giving by less than 50 percent.

The estimated price elasticity for low-income households in 1970 reflects the collinearity between price and income in this subsample. In higher income groups there are some taxpayers with low marginal rates and other taxpayers with high marginal rates. But among low-income taxpayers there are no high marginal rates. The large standard error of the price elasticity indicates that these data are just not sufficiently rich to provide accurate informaton on both price and income elasticities. However, by restricting the income elasticity and the effects of marital status and age to be the same at all income levels it is possible to obtain more precise estimates of the price elasticity. In effect, this procedure avoids the collinearity problem by using information about the effect of income at all levels in the estimation of the effect of price at each level. Equation 4.2 presents the estimated equation for 1970 with *five* separate price elasticities:

$$\begin{aligned}
\ln G = {} & \underset{(0.418)}{-2.264} \ln P(50)<10 \underset{(0.235)}{- 1.818} \ln P(50)10/20 \\
& \underset{(0.135)}{- 1.469} \ln P(50)20/50 \underset{(0.085)}{- 1.168} \ln P(50)50/100 \\
& \underset{(0.061)}{- 1.267} \ln P(50)>100 \underset{(0.031)}{+ 0.782} \ln Y \\
& \underset{(0.050)}{+ 0.365} MAR \underset{(0.039)}{+ 0.403} AGE \underset{(0.324)}{- 2.843}
\end{aligned} \tag{4.2}$$

$$\bar{R}^2_{1970} = 0.403$$

where $P(50){<}10$ is equal to $P(50)$ if the taxpayers' income is less than \$10,000 but equal to 0 otherwise, $P(50)10/20$ is equal to $P(50)$ if the taxpayers' income is between \$10,000 and \$20,000 but equal to 0 otherwise, and so forth. The implied price elasticity in the lowest income class is now -2.26 with a standard error of 0.42 and thus rather similar to the corresponding price elasticity with other bodies of data. The other price elasticities at income below \$50,000 are also slightly higher than the constant price elasticity of equation 2.4 while the price elasticity between \$50,000 and \$100,000 is very slightly lower.

These attempts to estimate separate price elasticities for individual income classes indicate the difficulty of obtaining such information. The disaggregated results are generally much less accurate than the overall price elasticity. The low-income itemizers are an unrepresentable sample of low-income households. Nevertheless the current estimates and the previous evidence on this question do present a reasonably consistent and clear picture. First, there is evidence in all the sources of data that the price elasticity exceeds one for incomes over \$20,000. There is some indication that the elasticity may increase at the highest income level. Any estimate less than one has a large enough standard error to preclude excluding the possibility that the elasticity exceeds one. Second, the evidence suggests a higher absolute price elasticity for taxpayers with incomes below \$20,000, probably in the range of -2 to -3.

V

SIMULATED EFFECTS OF ALTERNATIVE TAX CHANGES

This section uses the basic parameter estimates for 1970 (equation 2.4) to calculate the effects of alternative changes in the income tax treatment of charitable contributions. The simulations show, for each income class, the change in the average gift, the change in the average income tax and the change in net disposable income after both taxes and contributions. The effect on aggregate giving and on gifts to particular types of donees will also be presented. All of the estimates are for 1970 and use the 1970 Treasury Tax File.

Any change in the income tax law will alter the price of charitable contributions that a taxpayer faces. Let P_i be the current price faced by individual i and P_i' be the price after a proposed change in the tax law. Similarly let G_i be the current charitable contribution of that individual and G_i' the contribution after the change in the tax law. Consider first how the calculation of the effect of a tax change would be done if all households filed itemized returns. For a change in the tax law that alters only price and not income[18] or the demographic dummy variables, it follows that the predicted change in the individual's contribution is:

$$\ln G_i' - \ln G_i = -1.285\ (\ln P_i' - \ln P_i)\ . \tag{5.1}$$

Since the current actual giving is known for individual i, equation 5.1 can be used to calculate the expected giving under the alternative tax system. If the tax change alters income as well,[19] the change in giving is:

$$\begin{aligned}\ln G_i' - \ln G_i = {} & -1.285\ (\ln P_i' - \ln P_i) \\ & + 0.702\ (\ln Y_i' - \ln Y_i)\ .\end{aligned} \tag{5.2}$$

To extend the calculation to taxpayers who do not itemize, it is necessary to estimate the amounts of the contributions that are currently made by these individuals. Let $\hat{G}_i$ be the estimated gift in 1970 by individual i who used the standard deduction. Similarly, let $\hat{G}_i'$ be the gift that the individual would make under the alternative tax treatment of charitable contributions. Since $\hat{G}_i$ is unknown, the value of $\hat{G}_i'$ cannot be estimated from the expected *change* in giving as it was on the basis of equation 5.1 for taxpayers who itemize. Instead, we now estimate $\hat{G}_i$ and $\hat{G}_i'$ separately on the assumption that the only relevant defference between itemizers and non-itemizers with the same income is the different price that they currently face.[20]

Because the estimated equations for itemizing taxpayers do not explain their giving perfectly, there is a residual difference between actual giving and the giving predicted on the basis of equation 2.1. Each residual reflects the use of a loglinear approximation and the omission of variables other than income, price, and the two demographic effects. These residual differences are automatically taken into account for itemizing taxpayers by the method of equation 5.1. For the non-itemizing taxpayers, an estimate of the residual is calculated by averaging the residuals of all itemized returns in that individual's income class; for this purpose nine income classes are used. With u_i estimated in this way, the calculated value of giving by non-itemizer i is simply the value predicted by equation 2.1 with the appropriate values of P_i and Y_i plus the estimated residual u_i.

The Treasury Tax File provides a weight for each individual return. The estimates for each individual can therefore be aggregated to yield totals for each income class and for all households that file returns.

The data for estimating the effect on individual donees are much less adequate than the data that are available for estimating the effect on all types of donees together. Every second year the Internal Revenue Service publishes the value of itemized charitable contributions in 17 adjusted gross income classes. For 1962 only, the published report divided these contributions into five major types of charities: (1) religious organizations, (2) educational institutions, (3) hospitals, (4) health and social welfare organizations (including United Funds, the Red Cross, and specific disease associations) and (5) a residual group including libraries, museums, zoos, musical organizations, and literary, educational, and scientific foundations. This is the only source of data on the distribution among different types of charities of the contributions of middle- and high-income households. Feldstein[21] used these data to estimate separate price and income elasticities for giving to the five different types of donees. That analysis showed that gifts to religious organizations and to health and welfare organizations have lower price and income elasticities than gifts to the other types of charities. This was confirmed by estimates using three different specifications. The current simulations use the quite conservative assumption that the price elasticity is actually the same for all the donees and that only the income elasticities differ.[22] This tends to reduce the sensitivity of gifts to educational institutions and hospitals relative to the sensitivity of gifts to religious and health and welfare organizations. Since the educational institutions and hospitals are still much more sensitive than other types of donees, this type of conservative assumption is probably warranted by the general inadequacy of the data on giving to individual types of donees.

Consider first the implications of completely eliminating the deduction without substituting any other provision that encourages charitable giving. The simulation indicates that this would reduce total giving in 1970 from $17.3 billion[23] to $12.8 billion, a decrease of 26 percent. Eliminating the deduction also increases total tax revenue by $3.5 billion. This implies that the current deductibility induces $1.29 of additional charitable giving per dollar of revenue lost.

Table 4 shows that the reduction in contributions differs substantially among the five major types of donees. Religious giving falls least, only 22 percent. This reflects the concentration of religious giving in the lower-income households for whom the price change implied by eliminating the deduction would be least. In contrast, gifts to educational institutions and hospitals would fall nearly 50 percent. Community health and welfare organizations are more similar to religious organizations while the residual category contains museums, orchestras, zoos, and other charities favored by higher-income donors.

Table 4

Effects of Eliminating the Charitable Deduction

	Contributions in 1970 (in millions of dollars)		
	Actual	Predicted with no Deduction	Percentage Change
Religious organizations	$10,441	$ 8,158	-22%
Educational institutions	679	355	-48
Hospitals	289	156	-46
Health and welfare organizations	2,499	1,819	-27
All others	3,417	2,281	-33
Total giving	$17,324	$12,770	-26%

Table 5 presents detailed results of the effects by income classes.[24] The average contribution in 1970 is given for broad income classes in column 3, and the corresponding prediction if the deduction were eliminated appears in column 4. The ratios of predicted contributions to actual contributions that are presented in column 5 show that the relative reduction in giving is much greater among high-income classes than in lower-income classes. While taxpayers with adjusted gross incomes between $10,000 and $15,000 would reduce their gifts by 22 percent (from an average of $290 to $225), a reduction of 75 percent is predicted for taxpayers in the $100,000 to $500,000 class (from $9,184 to $2,246).

Eliminating the charitable deduction would raise the average taxes paid in every income class but the increase would be greatest at the higher income levels. Column 6 shows the ratios of the tax payments if the deductions were eliminated to the actual tax payments in 1970. Although taxes rise by only 3.4 percent in the $10,000 to $15,000 class, taxes rise by 14.8 percent in the class of taxpayers with incomes of $500,000 to $1,000,000.

The distributional effect of eliminating the deduction is quite different if we focus on the change in net disposable income rather than the change in tax payments. Net disposable income available for personal consumption or saving is defined as adjusted gross income minus both the taxes actually paid and the charitable contributions. Because charitable contributions fall sharply in the higher income groups when the deduction is eliminated, their predicted consumptions and savings increase despite the greater taxes that they pay. Column 7 presents the ratio of predicted net disposable income to actual 1970 net disposable income. Net disposable income rises at every income level, with the increase ranging from less than 0.3 percent for incomes under $50,000 to more than 5 percent over $500,000.

Most of those who have suggested eliminating the charitable deduction have proposed that some alternative be introduced to encourage charitable giving. Table 6 summarizes the effects that several different common proposals would have on total charitable giving, total taxes paid, and on charitable gifts to educational institutions. Perhaps the most common proposal has been to replace the deduction with a tax credit. While the deductiom makes each individual's price depend on his own

Table 1

Distribution of Charitable Giving by Price and Net Income, 1970*

(Each cell presents the number of returns and the average ratio of charitable giving to net income)

	Net Income											
Price	2,000	2,000-4,000	4,000-6,000	6,000-8,000	8,000-10,000	10,000-15,000	15,000-20,000	20,000-50,000	50,000-100,000	100,000-500,000	500,000-1,000,000	1,000,000+
0.31	–	–	–	–	–	–	–	–	260 0.093	2,992 0.159	33 0.359	16 0.740
0.31-0.37	–	–	–	–	–	–	–	–	2,508 0.077	2,105 0.137	73 0.315	46 0.307
0.37-0.46	–	–	–	–	–	–	–	1,410 0.049	5,845 0.055	2,333 0.092	42 0.064	12 0.039
0.46-0.61	–	–	–	–	–	–	–	6,045 0.039	2,099 0.053	1,599 0.057	45 0.026	8 0.013
0.61-0.72	–	–	–	–	1 2,810	4 0.039	2,476 0.031	5,334 0.033	308 0.061	313 0.038	9 0.016	7 0.013
0.72-0.75	–	–	–	–	–	1,748 0.031	3,554 0.029	769 0.057	37 0.038	55 0.038	3 0.037	1 0.006
0.75-0.78	–	–	–	–	251 0.044	4,867 0.029	1,259 0.029	321 0.041	26 0.073	36 0.028	4 0.019	1 0.002
0.78-0.81	–	–	61 0.081	746 0.044	1,909 0.033	2,161 0.031	253 0.043	109 0.069	20 0.094	34 0.030	2 0.010	1 0.006
0.81-0.86	3 0.068	283 0.081	1,016 0.053	987 0.043	427 0.049	214 0.058	42 0.103	70 0.082	20 0.032	74 0.015	6 0.004	2 0.001
0.86-1.00	111 0.326	233 0.091	222 0.069	89 0.073	54 0.063	40 0.092	15 0.027	58 0.078	37 0.036	113 0.028	18 0.020	6 0.010

*Net income is AGI minus the federal tax liability with no charitable contributions. These returns are for married taxpayers less than age 65.

Table 2

Tax Changes and Charitable Giving: A Comparison of 1962 and 1970

Income ($000's)[a]		Ratio of Contribution to Income			Price of Cash Gifts			Arc Elasticity[b]	Price of Gifts Including Assets (p50)		
1962 (1)	1970 (2)	g62 (3)	g70 (4)	g70/g62 (5)	p62 (6)	p70 (7)	p70/62 (8)	(9)	p62 (10)	p70 (11)	p70/p62 (12)
10-12	13.6	.035	.031	.886	.750	.763	1.017	-7.180	.749	.761	1.016
12-15	16.6	.037	.032	.865	.718	.735	1.024	-6.114	.717	.733	1.022
15-20	21.6	.040	.033	.825	.654	.695	1.063	-3.149	.653	.692	1.059
20-30	30.8	.048	.041	.854	.532	.605	1.137	-1.229	.530	.600	1.132
30-40	43.2	.060	.046	.767	.434	.517	1.191	-1.518	.432	.506	1.171
40-50	55.5	.092	.064	.696	.369	.452	1.225	-1.796	.367	.440	1.199
50-60	67.8	.115	.067	.583	.303	.420	1.386	-1.653	.287	.392	1.366
60-70	80.1	.152	.075	.493	.295	.408	1.383	-2.181	.279	.380	1.362
70-85	95.6	.179	.097	.542	.275	.378	1.375	-1.923	.218	.348	1.349
85-100	114.1	.189	.118	.624	.296	.398	1.345	-1.591	.280	.370	1.321
100-150	154.1	.224	.143	.638	.318	.382	1.201	-2.454	.290	.323	1.114
150-200	215.8	.229	.162	.707	.350	.400	1.143	-2.590	.314	.323	1.029
200-350	339.1	.256	.202	.789	.370	.413	1.116	-2.159	.325	.338	1.027
350-500	524.0	.230	.195	.848	.366	.423	1.156	-1.137	.321	.349	1.087
500-750	770.6	.257	.213	.829	.418	.448	1.072	-2.697	.366	.366	1.000
750-1000[c]	1078.9	.284	(.300)	(1.056)	.435	(.421)	(0.968)	-1.675	.384	(.335)	0.872

a. Income is AGI minus the federal tax liability with no charitable contributions. 1970 incomes correspond to the same real income as the mid point of the 1962 range.

b. Arc elasticity estimated as $\hat{\eta} = [\ln (g70/g62)] / [\ln (p70/p62)]$

c. Figures in parentheses are uncertain because of interpolation procedure.

Table 5

Distributional Effects of Eliminating the Charitable Deduction, 1970

AGI Class ($000's) (1)	Number of Itemized Returns (2)	Average Charitable Contributions G_i (3)	G'_i (4)	G'_i/G_i (5)	Tax Ratio (6)	Net Disposable Income Ratio (7)
0-5	28,350,064	$ 90	$ 86	0.949	1.029	1.000
5-01	21,540,224	207	175	0.844	1.033	1.001
10-15	13,686,661	290	225	0.778	1.034	1.001
15-20	5,532,010	392	277	0.707	1.037	1.002
20-50	3,568,912	690	408	0.591	1.015	1.003
50-100	353,158	2,022	756	0.374	1.053	1.006
100-500	74,631	9,184	2,246	0.245	1.090	1.017
500-1000	1,795	72,038	12,646	0.176	1.148	1.048
1000+	655	257,678	54,912	0.213	1.135	1.099
Average		237	175	0.737	1.042	1.002

Table 6

Effects of Alternative Tax Treatments of Charitable Giving
(in billions of 1970 dollars)*

Simulation No.	Proposal	Change in Total Gifts	Change in Tax Payments	Percentage Change Total Gifts	Percentage Change Gifts to Educational Institutions
1.	Eliminate deduction	-4.555	+3.521	-26	-48
2.	25% tax credit	+0.685	-0.725	+ 4	-24
3.	30% tax credit	+2.304	-2.060	+13	-17
4.	Floor on deduction: 3% of AGI	-3.515	+2.727	-20	-36
5.	Constructive realization of gifts	-0.458	+0.287	- 3	- 8
6.	Limit maximum charitable deduction to taxes paid	-0.073	+0.046	- 0.5	- 2
7.	30% optional credit, all returns	+3.448	-2.957	+20	+ 8
8.	30% optional credit, itemizers only	+1.532	-1.308	+ 9	+ 4
9.	Extend the deduction to non-itemizers	+1.241	-0.993	+ 7	+ 3
10.	Increase standard deduction (min. $1500, max. $2500)	-0.975	-8.259	- 6	- 3

*All price elasticities based on appreciated asset gifts valued at "discounted gain to value ratio." Total gifts, $17.3 billion. Educational gifts, $679 million.

marginal tax rate, the tax credit would make every taxpayer face the same price.[25] Proposal number 2 of Table 6 shows the predicted results of replacing the current deduction with a uniform tax credit of 25 percent. With this rate of credit, total giving and the total tax collections of the Treasury remain approximately at their current levels: giving increases by $0.69 billion while taxes fall by $0.73 billion. Although the aggregates are essentially unchanged, the impacts on particular donees and particular individuals differ substantially. Gifts to religious organizations actually increase by about 9.8 percent while gifts to educational institutions fall by 24 percent. The net disposable income of individuals with incomes between $10,000 and $15,000 would remain almost unchanged while individuals with incomes above $500,000 would increase their net disposable incomes by 6.4 percent. Proposal 3 shows that even a 30 percent tax credit, which would cost the Treasury an additional $2 billion in foregone revenues, would still leave educational institutions with a 17 percent reduction in gifts.

Another common proposal is to continue the current deduction but to limit it to contributions in excess of some percent of income. Simulation 4 of Table 6 shows the effect of a 3 percent of adjusted gross income floor. Total giving would fall by 20 percent and gifts to educational institutions would fall by 36 percent. This probably overstates the effect because it assumes that individuals do not accumulate the contributions for several years in order to take advantage of the deduction. The frequent comparison of this floor to the current medical expense floor is inappropriate because of the much greater ease with which charitable gifts can be postponed and "bunched" to obtain the deduction.

Several critics of the current tax treatment of charitable gifts have proposed changing the treatment of gifts of appreciated property by treating such gifts as realization for tax purposes. This would eliminate the desirability of donating property and would substantially increase the effective price for high-income donors. Simulation 5 of Table 6 shows that this change would have a relatively small total effect but would reduce gifts to educational institutions by 8 percent. Moreover, the net disposable income would rise for high-income taxpayers. For individuals with incomes over $500,000, the simulation shows that net disposable income would rise by 2 percent if the constructive realization of property gifts were instituted.

Much of the public and political criticism of the current tax treatment of charitable gifts occurs because some high-income individuals make substantial charitable gifts but pay no income taxes. Although the current rules that limit charitable giving to no more than 50 percent of adjusted gross income were intended to prevent such avoidance of tax, individuals with sufficient noncharitable deductions are still able to pay no tax while making substantial deductible gifts. There is a simple way to eliminate this problem by changing the nature of the contribution limit to a limit in relation to tax paid instead of the current limit in relation to adjusted gross income. For example, each individual's charitable deduction might be limited to no more than the amount of tax that he actually pays in that year. Simulation 6 of Table 6 shows that this would have very little effect on total giving (a reduction of 0.5 percent) or on gifts to educational institutions (a reduction of 2 percent).

Not all proposals to change the tax treatment of charitable gifts would reduce giving. Some have proposed to increase the incentive to lower-income households while maintaining the current deduction for higher-income households. One way to do this is by an optional credit, leaving individuals the opportunity to use either the deduction or a credit of, say, 30 percent. Proposal 7 shows that such an option would cost an additional $3 billion of foregone revenue but would increase total giving by 20 percent and educational gifts by 8 percent. If the optional credit were limited to itemizers only (on the grounds that non-itemizers are implicitly given a tax reduction for charitable gifts in the standard deduction), the cost to the government would fall to only $1.3 billion while gifts would increase by only 9 percent (see Simulation 8 of Table 6). A quite different type of stimulus would be achieved by extending the opportunity for charitable deductions to those who do not itemize other deductions (option 9). This would cost approximately $1 billion in lost taxes and would stimulate giving by 7 percent, primarily to religious organizations. Some change of this type may be regarded as important to offset the effect on giving that would otherwise result from the currently proposed increase in the standard deduction. Simulation 10 of Table 6 shows that increasing the minimum standard deduction to $1,500 and the maximum standard deduction to $2,500 would, in 1970, have decreased total giving by some 6 percent.

VI

CONCLUSION

This paper has presented a detailed analysis of the sensitivity of charitable giving to alternative tax treatments. Three different sets of estimates were developed: cross-section estimates for the 1962 and 1970 Treasury Tax Files and estimates based on the change in tax rates at each income level between these two years. All three sets of estimates agree in placing the key price elasticity between −1.0 and −1.5. This value implies that the current deductibility of charitable gifts is a very efficient incentive, yielding more in additional gifts than the Treasury foregoes in potential additional revenue.

The price and income elasticities estimated in the current study are also very similar to the values obtained in Feldstein[26] and Feldstein and Clotfelter[27] with very different types of data. Feldstein used total contributions on itemized returns as reported by the Internal Revenue Service for each adjusted gross income class in even years from 1948 through 1968. The basic estimate of the price elasticity with that data was −1.17. The analysis of Feldstein and Clotfelter used a large survey of individual households with a sample that was heavily weighted toward high-income households. With that data the key price elasticity was −1.15. In short, there is very strong evidence from a variety of sources for the current conclusion about the relatively high price elasticity of charitable giving.

Legal discussions of the appropriate tax treatment of charitable gifts have stressed the abstract logic of a consistent definition of taxable income.[28] In contrast, we have emphasized the empirical effects of alternative policies on both donees and donors. We believe that the effect of alternative tax treatments on the volume and distribution of gifts among donees and on the distribution of tax liabilities and of net disposable income among taxpayers are the crucial aspects for evaluating these proposals. We hope that the evidence presented in this study will provide a useful foundation for future policy discussions.

Acknowledgements

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Footnotes

1. Martin Feldstein, "The Income Tax and Charitable Contributions: Part I - Aggregate and Distributional Effects," *National Tax Journal*, 28:1 (March 1975), pp. 81-99.

2. Martin Feldstein, and Charles Clotfelter, "Tax Incentives and Charitable Contributions in the United States: A Micro-econometric Analysis," *Journal of Public Economics* (forthcoming), 1974.

3. If the individual gives the asset away to another person, there is no constructive realization and the tax is postponed until the recipient sells the asset. The original owner can also consume most of the value of the asset by using it as collateral to borrow funds which he then consumes, thus enjoying the consumption while postponing or avoiding the capital gains tax. See Martin Bailey, "Capital Gains and Income Taxation," in A. Harberger and M. Bailey (eds.), *The Taxation of Income from Capital* (Washington: The Brookins Institution, 1969), for evidence that a very large share of accrued capital gains are never subject to capital gains taxation.

4. The correlation between $1-m$ and $1-m-mc(1-B/V)\alpha$ would be 1 if mc were proportional to m. In fact, $mc = 0.5m$ for all taxpayers with marginal rates below 0.50; until 1969 $mc = 0.25$ for all other taxpayers while after that $mc = 0.25$ only for the first $50,000 of capital gains.

5. We are grateful to the Brookings Institution for making the 1962 file available to us.

6. Feldstein, op. cit; Feldstein and Clotfelter, op. cit.

7. This raises the residual sum of squares for 1970 by less than 0.2 percent. The data are thus quite uninformative about this parameter.

8. The price elasticity varies with the assumed "discounted gain to value ratio" although these differences are not large. For example, the 1970 price elasticity was −1.083 at the ratio of 0.875. The change implication of changing the gain to value ratio is therefore partly offset by the resulting change in the price elasticity. The aggregate effect of eliminating the deductibility of contributions is therefore influenced much less by the assumed gain to value ratio than either that ratio or the price elasticity alone would imply. The estimated effect of other changes, e.g., the substitution of a credit for the deduction, are more sensitive and additional evidence on this question would be very useful.

9. More exactly, $(1.25)^{-1.285} = 0.75$, implying that contributions are decreased by 25 percent or $75. This assumes that the increased tax revenue is not redistributed to the taxpayers; allowing for such a tax cut would have almost no effect since the individuals would spend only about two percent of the increased disposable income on charity.

10. This has been stressed by, among others, Henry Aaron, "Federal Encouragement on Private Giving," in *Tax Impacts of Philanthropy* (Princeton, N.J.: Tax Institute of America, 1972; Harry Kahn *Personal Deductions in the Federal Income Tax* (Princeton, N.J.: Princeton University Press, 1960); Paul McDaniel, "An Alternative to the Federal Income Tax Deduction in Support of Private Philanthropy," in *Tax Impacts on Philanthropy* (Princeton, N.J.: Tax Institute of America, 1972); and William Vickrey, "One Economist's View of Philanthropy," in Frank Dickinson (ed.), *Philanthropy and Public Policy* (1962), pp. 31-56.

11. Feldstein, op. cit.

12. Feldstein and Clotfelter, op. cit.

13. Michael Taussig, "Economic Aspects of the Personal Income Tax Treatment of Charitable Contributions," *National Tax Journal*, 20:1 (March 1967), pp. 1-19.

14. Taussig's estimates are based on a specification like the current equation 2.1 except that the logarithm of the marginal tax rate is used instead of the logarithm of price. Reestimating our equation with the logarithm of marginal rate instead of the logarithm of price does not alter our conclusions.

15. An attempt to reproduce Taussig's exact specification produced an elasticity of 0.24 with respect to the marginal tax rate. The implied elasticity with respect to price is $-0.24\ P/(1-p)$. Thus at a price of 0.6 the implied elasticity is -0.36.

16. Reported in Taussig, "The Charitable Contributions Deduction in the Federal Personal Income Tax," unpublished doctoral dissertation, Massachusetts Institute of Technology, 1965.

17. Feldstein and Clotfelter, op. cit.

Some new evidence based on a special survey conducted by the Survey Research Center of the University of Michigan provides further support for relatively high price elasticities for low-income households. The alternative price elasticities based on different estimating methods for households with incomes under $30,000 in 1973 center between −2.0 and −3.0. See Michael Boskin, and Martin Feldstein, "Effects of the Charitable Deduction on Constributions by Low Income and Middle Income Households," mimeo, 1975.

18. These calculations assume that the government does not change tax rates to offset any change in total revenue resulting from the change in the tax treatment of contributions. Allowing for such a compensating change would have relatively little effect on charitable giving since the average propensity to spend on charitable giving is only about 3 percent.

19. This is true for such proposals as the minimum tax that affect not only the tax treatment of charity.

20. Feldstein and Clotfelter, op. cit., using survey data on giving by itemizers and non-itemizers, show that there is little difference in their income and price elasticities and that a variety of other economic and demographic factors have no effect on giving when income and price are taken into account.

21. Martin Feldstein, "The Income Tax and Charitable Contributions: Part II - The Impact on Religious, Educational and Other Organizations," *National Tax Journal* (forthcoming). 1974.

22. The actual technique is to assume that each individual's total gift is divided among donees in proportions that depend on his income class but not on the specific provisions of the tax law.

23. In 1970 total giving on itemized returns was $13.0 billion. The remaining $4.3 billion is our estimate of the total giving by taxpayers who filed non-itemized returns (i.e., who used the standard deduction). This amount is estimated for each non-itemized return and aggregated with the appropriate weights. Note that this procedure omits a small amount of giving by those households with income so low that they are not required to file returns. Our reestimate is nevertheless higher than the estimate of individual giving that is produced by the American Association of Fund-Raising Counsel, *Giving USA* (1974),, using methods that we believe are much less accurate.

24. A similar table based on aggregate data was published in Feldstein (1975) op. cit. In comparing the tables it should be borne in mind that the current estimates are for all taxpayers while the previous table referred only to taxpayers who filed itemized returns.

25. A tax credit is equivalent to a matching grant except that the tax credit in these simulations is limited to the individual's tax liability, i.e., the tax credit is non-refundable. A refundable credit is exactly equivalent to a matching grant. In practice the difference would be small because of the relatively small aggregate giving by individuals who do not currently file taxable returns.

26. Feldstein (1975), op. cit.

27. Feldstein and Clotfelter, op. cit.

28. William Andrews, "Personal Deductions in an Ideal Income Tax," *Harvard Law Review*, 86:2 (Dec. 1972) pp. 309-385; Boris Bittker, "The Propriety and Vitality of a Federal Income Tax Deduction for Private Philanthropy," in *Tax Impacts on Philanthropy* (Princeton, N.J.: Tax Institute of America, 1972); Stanley Surrey, *et al.*, *Federal Income Taxation* (Mineola, N.Y.: The Foundation Press, Inc., 1972).

EFFECTS OF THE CHARITABLE DEDUCTION ON CONTRIBUTIONS BY LOW-INCOME AND MIDDLE-INCOME HOUSEHOLDS: EVIDENCE FROM THE NATIONAL SURVEY OF PHILANTHROPY

Michael J. Boskin† and Martin S. Feldstein*

Introduction

Economists and tax lawyers have long debated the efficacy and propriety of the income tax deduction for charitable contributions.[1] The effect of the deduction is to lower the individual's net cost of giving if he itemizes his deductions. More specifically, the net cost to the donor per dollar received by the charitable donee is equal to one minus the individual's marginal tax rate.[2] If the elasticity of total giving with respect to this price (or net cost) is absolutely greater than one, the charitable deduction causes donees to receive more in additional gifts than the Treasury foregoes in revenue. Alternatively, if the price elasticity is absolutely less than one, the deduction is less than fully efficient in this sense.

In a series of recent papers, Feldstein and his collaborators[3] obtained estimates of the price elasticity that cluster around -1.2 from a variety of different data sources. All but one of these studies[4] (Feldstein and Clotfelter, 1974) are based on the gifts of taxpayers who itemize their deductions. Since substantially more than half of the households either do not itemize deductions or do not file any tax return, the estimated price elasticities have been obtained primarily from the top half of the income distribution. While this part of the population accounts for a disproportionate share of charitable contributions, extrapolation to the entire population may not be warranted. A variety of policy proposals that are currently being considered, for example, a tax credit for all taxpayers for charitable gifts or extension of the charitable deduction to non-itemizers, would alter the price of giving for households that do not now itemize. An accurate estimate of the price elasticity for this income group is required to predict the effects of such policies.

The purpose of the present paper is to provide such a price elasticity estimate for low- and middle-income households. We use a new data source that provides survey information on charitable giving in 1973 by non-itemizers as well as for those who filed itemized returns. Chapter I describes that data and discusses the problems of definition and measurement.

Chapter II presents the basic results of our study, estimates of the price and income elasticity of giving to charity by low- and middle-income households. The third chapter discusses the separate price elasticities estimated for different income groups within the population of households with incomes under $30,000. *The current results indicate that these households are very sensitive to tax-induced variations in the cost of giving; the estimated price elasticities generally exceed two.*

Chapter IV tests the hypothesis that there is a separate "itemization effect," that is, that the mere fact of itemization and not the lower price caused by the deduction induces an increase in giving. The estimates cause us to reject this hypothesis. The higher giving by itemizers can be explained by the price differential alone.

Finally, Chapter V offers a brief conclusion developing the implication of these results for tax policy.

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After this paper was written the Michigan Survey Research Center notified us of a small error in the definition of some of the variables. We have reestimated the basic equations and our results are essentially unchanged.

I

THE DATA

The data for this study were collected by the 1974 National Study of Philanthropy, a special household survey conducted by the Survey Research Center of the University of Michigan. The survey was sponsored by the Commission on Private Philanthropy and Public Needs to provide observations on contributions of money and time, as well as on income, tax rates, and other related information for about two thousand households.[5] Because our focus is on the behavior of low- and middle-income households, data for households with incomes over $30,000 were deleted. In order to ameliorate partially the problem of using current rather than permanent income, we have also deleted all households that reported incomes below $1,000. The key variables used in the analysis will now be described.

Charitable Contributions

The dependent variable of our study is the value of the households's gift to charity in 1973 in the form of both cash and property. Because we will estimate a loglinear equation to obtain constant price and income elasticities, the small fraction of households that report no contribution pose a problem. We believe that most of those who report no giving actually did give a small amount which has since been forgotten or was regarded as too small to mention. Three alternative modifications of the reported giving have therefore been examined. First, we assigned a gift of $1 to all those who reported no giving; if reported giving is denoted G, this estimate is $G1 = G$ if $G>0$ and $G1 = 1$ if $G = 0$. The second alternative assigns $10 instead: $G10 = G$ if $G>0$ and $G10 = 10$ if $G = 0$. Finally, we try adding $10 to everyone's reported giving; this variable is denoted $G + 10$. We also estimated equations using a regression specification which directly accounts for the non-negativity and piling up at zero of charitable contributions. The results of this procedure (which are available upon request) are quite similar to our basic results.[6]

Price

For households that itemize their deductions, the price of a one dollar charitable gift is $1-m$, where m is the household's marginal tax rate. For those households that do not itemize, the price is simply 1. Because charitable deductions are almost always a small part of a taxpayer's itemized deduction, we assume that the decision to itemize is exogenous.

No adjustment is made for the special tax treatment of appreciated property since such gifts are very unimportant in the income range that we are concerned with in this paper. In 1970, the last year for which data are currently available, only 4 percent of charitable gifts were not in the form of cash for taxpayers with incomes below $30,000.[7]

Two different definitions of the marginal tax rate have been studied. P1 was the estimated marginal tax rate that the individual would face if he made no charitable gift, that is, P1 is the price for the first dollar of charitable giving. Alternatively, P2 uses the estimated marginal tax rate that the individual would face if he made the average charitable contribution in his income class. Both measures assure that the individual's price measure is exogenous, that is, not a function of his own amount of charitable giving.

The relevant marginal rate was estimated for each taxpayer on the basis of his reported total income, the number of his dependents, family status, and an estimate of the amount of noncharitable deductions.

Income

The survey collected information on the respondent's income bracket but not his exact income.[8] We have used the midpoint of each narrow bracket to measure gross income.

The net income variable, Y, is defined as gross income minus the federal income tax liability that would have been paid had no charitable contribution been made.

The survey collected some data on wealth but did not obtain any information on debts or the value of pension rights. We have therefore not explored the implications of wealth here.[9]

Age

The fraction of income contributed to charity increases with age. Feldstein and Clotfelter[10] showed that this is true even after adjusting for price, income, and wealth. The current study therefore includes three age dummy variables to measure proportional shifts in giving: A3554 = 1 if the head of the family is aged between 35 and 54 and equal to zero otherwise, A5564 = 1 if the head is 55 to 64, and A65+ = 1 if the head is over 64. The omitted category is households with heads under age 35.

Separate estimates were also made with the sample limited to households containing a married couple with the head between the ages of 35 and 54. This should eliminate the special problems of transitory income associated with young households, the aged, widows, and so forth.

Other Variables

A variety of other variables were included in some formulations: the sex of the household head, race, education, religion, and so forth.

II

THE BASIC RESULTS

Equation 2.1 presents the basic estimate of the price and income elasticities for the sample of households with incomes between $1,000 and $30,000:

$$\ln (G+10) = \underset{(0.259)}{-2.405} \ln P1 + 0.697 \ln Y + \underset{(0.069)}{0.440} \text{ AGE } 3554$$

$$+ \underset{(0.090)}{0.754} \text{ AGE } 5564 + \underset{(0.095)}{0.861} \text{ AGE } 65+ \; - 2.235 \qquad (2.1)$$

$$N = 1621, \; R^2 = 0.30, \; SSR = 2123.46$$

Note first that the estimated price elasticity (-2.405) is very large and significantly greater numerically than one. The elasticities and age effects are all estimated quite precisely.

The estimated price elasticity is quite consistent with results obtained for low- and middle-income groups in the previous studies. The table below summarizes the previous elasticities. With the exception of the improcise and insignificant unconstrained value based on the 1970 Internal Revenue Service Tax File, [11] the average of the previous estimates (-2.4) is the same as the current estimate.

The estimated price elasticity for low- and middle-income households is thus substantially larger than the corresponding elasticity for higher income groups. The previous studies for the entire population found overall price elasticities that clustered around -1.2.[12]

A COMPARISON OF PRICE ELASTICITIES
FOR LOW- AND MIDDLE-INCOME HOUSEHOLDS

Source of Data	Income Class	Price Elasticity	Standard Error
1962 FRB Survey[a]	$1,721-8,000	-2.50	0.91
1962 FRB Survey, Constrained[b]	$1,721-8,000	-2.07	0.80
1962 Tax File[c]	$4,000-20,000	-3.67	0.45
1970 Tax File[c]	$4,000-20,000	-0.35	0.52
1970 Tax File Constrained[b]	$4,000-10,000	-2.10	0.40
1970 Tax File, Constrained	$10,000-20,000	-1.59	0.23

a. See Martin Feldstein and Charles Clotfelter, "Tax Incentives and Charitable Contributions in the United States: A Microeconometric Analysis," Journal of Public Economics (forthcoming), 1974, for a description of Survey and estimates.

b. Constrained estimates are separate price elasticities by income class within a single equation for all observations.

c. See Feldstein and Amy Taylor, "The Income Tax and Charitable Contributions: Estimates and Simulations with the Treasury Tax Files," Harvard Institute of Economic Research Discussion Paper number 409, April 1975, for a description of the Treasury Tax File and the estimates. These figures refer to itemized returns only.

The estimated price elasticity of -2.4 implies that contributions are very sensitive to their tax treatment. The current deductability of contributions substantially increases the total value of gifts by these lower- and middle-income households. For each dollar of revenue that the Treasury foregoes because of the charitable deduction, donees receive an additional $2.40.

As we noted above, several alternative adjustments were made to deal with households that reported no gift to charity. Replacing these zero reports by $10 (instead of adding $10 to *all* reported gifts) slightly increases the estimated price elasticity:

$$\begin{aligned} \ln G10 = {} & \underset{(0.266)}{-2.506 \ln P1} + \underset{(0.056)}{0.720 \ln Y} + \underset{(0.071)}{0.450\ AGE\ 3554} \\ & + \underset{(0.092)}{0.767\ AGE\ 5564} + \underset{(0.097)}{0.884\ AGE\ 65+} \underset{(0.265)}{-2.505} \end{aligned} \tag{2.2}$$

$$N = 1621,\ R^2 = .31,\ SSR = 2229.809$$

Since the logarithmic transformation becomes quite steep as we approach zero, the adjustment that adds only one dollar to the zero reported by some households yields a high price elasticity that may overstate the difference in giving for small price differences:

$$\begin{aligned} \ln G1 = {} & \underset{(0.371)}{-2.872 \ln P1} + \underset{(0.079)}{0.938 \ln Y} + \underset{(0.099)}{0.581\ AGE\ 3554} \\ & + \underset{(0.129)}{1.022\ AGE\ 5564} + \underset{(0.136)}{1.159\ AGE\ 65+} - \underset{(0.070)}{4.969} \end{aligned} \tag{2.3}$$

$$N = 1621,\ R^2 = .26,\ SSR = 4349.617$$

In all three equations, the age coefficients confirm the importance of age as a separate determinant of giving. For example, the basic estimates of equation 2.1 imply that those aged 35 to 54 give 44 percent more than those less than 35, that those 55 to 64 give 31 percent more than those aged 35 to 54, and that those over 64 give 42 percent more than those aged 35 to 54. To show that this effect is basically a proportional shift and does not involve a changing price elasticity, we present a reestimate of equation 2.1 with the sample limited to households headed by a male between the ages of 35 and 54:

$$\ln (G+10) = \underset{(0.471)}{-2.913 \ln P1} + \underset{(0.111)}{0.776 \ln Y} - \underset{(1.001)}{2.619} \tag{2.4}$$

$$N = 543,\ R^2 = 0.29,\ SSR = 696.902$$

Finally, we can report that the substitution of P2 (the price based on average gift) for P1 (the price based on the first dollar of giving) has essentially no effect on the estimated parameters. Equation 2.5 presents the results with P2 that correspond to equation 2.1 with P1:

$$\ln (G+10) = \underset{(0.259)}{-2.412} \ln P2 - \underset{(00.055)}{0.700} \ln Y + \underset{(0.069)}{0.440} \text{ AGE } 3554$$

$$+ \underset{(0.090)}{0.754} \text{ AGE } 5564 + \underset{(0.095)}{0.863} \text{ AGE } 65+ - \underset{(0.492)}{2.229} \qquad (2.5)$$

$$N = 164,\ R^2 = 0.30,\ SSR = 2122.898$$

All of our basic results thus indicate that the price elasticity of charitable giving is numerically somewhat larger than −2 for those households with incomes between $1,000 and $30,000. We turn next to the question of whether the price elasticity varies within this income range.

III

ESTIMATING THE PRICE ELASTICITY BY INCOME CLASS

Since the price elasticity of charitable giving for the lower part of the income distribution is potentially so important in making sensible tax policy, we have attempted to obtain information on price elasticities by finer income ranges than the results reported above. We have estimated price elasticities for several different income ranges using several alternative formulations of our basis constant elasticity equation. It should be recognized that as we examine finer and finer income ranges, the amount of variation in price and income decreases and our sample size also decreases; it then becomes more difficult to obtain accurate separate estimates of price and income elasticities.

We begin by deleting households with incomes over $20,000. The estimation of our basic specification for incomes in the $1,000 to $20,000 range yields

$$\ln (G+10) = \underset{(0.291)}{-2.239} \ln P1 + \underset{(0.063)}{0.685} \ln Y + \underset{(0.076)}{0.398} \text{ AGE } 3554$$

$$+ \underset{(0.098)}{0.781} \text{ AGE } 5564 + \underset{(0.100)}{0.829} \text{ AGE } 65+ - \underset{(0.559)}{2.102} \qquad (3.1)$$

$$N = 1368,\ R^2 = .24,\ SSR = 1820.578$$

In spite of the potential problems of reduced variation and sample size that were mentioned above, we still obtain relatively precise estimates of the price and income elasticities. The price elasticity is again approximately −2.2.

When equation 3.1 is reestimated with the sample restricted to households headed by males aged 35 to 54, the estimated price elasticity is −2.76 (standard error, 0.35). Similarly, for households with married couples of all ages, the price elasticity is −2.5 (standard error 0.5). Finally, adding several other explanatory variables (the sex of the household head, race, religion, education, whether parents gave regularly) resulted in a price elasticity of −2.35 with a standard error of 0.26. Addition of these explanatory variables reduces the sum of squared residuals to 2068.69, a statistically significant improvement in fit. The separate estimated coefficients reveal that households headed by a college graduate or someone whose parents gave regularly gave about 25 percent more to charity, *ceteris paribus*, than those without these characteristics.

A second approach to estimating separate price elasticities by income class is to allow the price elasticity to vary while keeping the income elasticity the same for all income classes. (This is the specification described as the "constrained" elasticity in Table 1.) Equation 3.2 allows the price elasticity to differ between the income classes \$1,000 to \$10,000 and \$10,000 to \$20,000 while maintaining the assumption of a constant income elasticity and constant proportional age effects:

$$\begin{aligned} \ln(G+10) = {} & \underset{(0.477)}{-2.140} \ln P11 - \underset{(0.316)}{2.2271} \ln P12 \\ & + \underset{(0.067)}{0.679} \ln Y + \underset{(0.076)}{0.397}\ AGE\ 3554 \\ & + \underset{(0.098)}{0.783}\ AGE\ 5564 + \underset{(0.100)}{0.828}\ AGE\ 65+ - 2.047 \end{aligned} \tag{3.2}$$

$N = 1368$, $R^2 = .24$, $SSR = 1820.484$

where P11 is the price for those with incomes between \$1,000 and \$10,000 (and zero otherwise) and P12 is the price for those with incomes between \$10,000 and \$20,000 (and zero otherwise).

The separate price elasticities are quite close to the overall elasticity of −2.2; indeed, a formal test of the hypothesis that the price elasticities are equal yields F = 0.12, well below the critical F of 3.8 at the 5 percent level. There is thus no evidence in this estimate that those with incomes under \$10,000 have different price elasticities than the group with slightly higher incomes.

As an alternative way of obtaining a separate price elasticity for households with incomes below \$10,000 we estimated a separate regression for households in this income range alone. This allows the income elasticity and all of the age effects to take values that are specific to this income group. Equation 3.3 again shows

$$\begin{aligned} \ln(G+10) = {} & \underset{(0.517)}{-2.714} \ln P1 + \underset{(0.098)}{0.498} \ln Y \\ & + \underset{(0.117)}{0.245}\ AGE\ 3554 + \underset{(0.135)}{0.691}\ AGE\ 5564 \\ & + \underset{(0.120)}{0.711}\ AGE\ 65+ - \underset{(0.844)}{0.477} \end{aligned} \tag{3.3}$$

$N = 645$, $R^2 = .15$, $SSR = 795.719$

that charitable contributions appear to be quite price elastic for this low income group; the estimated price elasticity is −2.7.

The very low estimated income elasticity (0.48) is substantially lower than the values that were estimated with a wide income range. Since at the lower end of the income scale current income is more likely to include large negative transitory components, we reestimated equation 3.3 after deleting households with incomes under \$4,000. This raises the income elasticity to the usual range (0.92 with standard error 0.29) but leaves the price elasticity essentially unchanged (−2.68 with standard error 0.55).

The results reported in this section support the conclusion that charitable giving is quite price elastic over the entire range of income and may be greater for lower-income households. Since the current tax law lowers the price of giving to charity only for those who itemize their deductions and since a substantial percentage of low-income and middle-income households use the standard deduction instead of itemizing, the question arises as to whether the difference in charitable contributions across households which we attribute to price really reflects an effect of itemization itself. To this we now turn.

IV

IS THERE AN ITEMIZATION EFFECT?

To test for the presence of a pure "itemization effect" in addition to a price effect, we consider two alternate approaches. First, we use the sample of non-itemizers, all of whom face a price of 1, to estimate the income elasticity of charitable giving. This estimate is clearly not "contaminated" by either collinearity or any possible itemization effect. This income elasticity is then used as "prior information" which is imposed as a constraint on the itemizers in the sample to estimate the price elasticity. Since this price elasticity is based on data for itemizers only, there is again no itemization component in the estimated price elasticity.

Equation 4.1 shows that the income elasticity for non-itemizers is 0.64:

$$\begin{aligned} \ln(G+10) = {} & \underset{(0.063)}{0.635 \ln Y} + \underset{(0.105)}{0.304\ \text{AGE 3554}} \\ & + \underset{(0.131)}{0.867\ \text{AGE 5564}} + \underset{(0.1167)}{0.6931\ \text{AGE 65+}} - \underset{(0.569)}{1.634} \end{aligned} \tag{4.1}$$

(Non-itemizers only) N = 724, $R^2 = 0.16$, SSR = 889.191

Using this as an extraneous estimate of the income elasticity for the itemizers, we find a price elasticity of -2.3:

$$\begin{aligned} \ln(G+10) - 0.635 \ln Y = {} & -2.347 \ln P1 + \underset{(0.093)}{0.533\ \text{AGE 3554}} \\ & + \underset{(0.124)}{0.683\ \text{AGE 5564}} + \underset{(0.165)}{1.097\ \text{AGE65+}} \\ & - \underset{(0.205)}{1.671} \end{aligned} \tag{4.2}$$

(Itemizers only) N = 897, $R^2 = 0.08$, SSR = 1645.70

Similarly, imposing this income elasticity on the full sample yields a price elasticity of -2.6:

$$\begin{aligned}\ln(G+10) - 0.635 \ln Y = {} & \underset{(0.216)}{-2.567} + \underset{(0.069)}{0.442}\ \text{AGE 3554} \\ & + \underset{(0.818)}{0.747}\ \text{AGE 5564} + \underset{(0.092)}{0.836}\ \text{AGE65+} \\ & - \underset{(0.055)}{1.682}\end{aligned} \qquad (4.3)$$

$N = 1621,\ R^2 = 0.146,\ SSR = 3843.588$

The estimated price elasticity therefore appears to reflect a genuine price effect and not the effect of itemization per se.

A more direct test of the itemization effect is obtained by estimating separate constant terms for itemizers and non-itemizers in the constant elasticity function. Any itemization effect would show up in different constant terms. This is formally equivalent to estimating two separate equations for the two groups subject to the constraint that the income elasticity and proportional age effects are the same for the two groups. For our basic specification, this yields the equation 4.4:

$$\begin{aligned}\ln(G+10) = {} & \underset{(0.492)}{-2.220}\ \text{item} - \underset{(0.527)}{2.416}\ \text{non-item} - \underset{(0.793)}{1.529} \ln P1 \\ & + \underset{(0.058)}{0.721} \ln Y + \underset{(0.069)}{0.443}\ \text{AGE 3554} \\ & + \underset{(0.090)}{0.756}\ \text{AGE 5564} + \underset{(0.095)}{0.859}\ \text{AGE 65+}\end{aligned} \qquad (4.4)$$

$N = 1621,\ R^2 = 0.39,\ SSR = 2121.668$

Where item = 1 for itemizers (and zero otherwise) and non-item = 1 for non-itemizers (and zero otherwise).

The two constant terms are similar in magnitude and not significantly different. Comparing equation 4.4 with equation 2.1, we may use the sum of squared residuals from each to construct an F statistic to test the hypothesis that the coefficients of the itemizer and non-itemizer dummy variables are equal. This yields an F (1,1617) = 1.36; since the 0.05 initial value of F is 3.84, the difference between the constants is clearly insignificant. This implies that the lower price elasticity (-1.529, s.e. = 0.793) is irrelevant since equation 2.1 is really to be preferred to this unnecessarily elaborate specification.[13]

V

CONCLUSION

We have examined a new and rich body of data on philanthropic activity by households with incomes below $30,000. Using a variety of estimating equations and subsamples of the population, we find that in each case charitable contributions are quite price elastic throughout this range of income. Almost all of the evidence indicates a price elasticity that is absolutely greater than 2.

Our experience in discussing this work has taught us that some economists are at first surprised and skeptical about the high price elasticity because it seems "contrary to intuition and common observation." We do not agree with this view. Among families with adjusted gross incomes between $10,000 and $15,000 who itemize their deductions, the average price of giving is about 0.80 and the average annual giving is about $300. Eliminating the deduction would raise the price to 1, an increase of 25 percent. Would eliminating the deduction reduce average giving in this group by $100? If so, the elasticity is approximately −2. We doubt that intuition and common observation are capable of answering this question. We therefore do not find that the statistical estimates are in conflict with our informal judgement about the behavior of individuals in this group.

This discussion does imply an important caution in interpreting high price elasticities for low-income families. An elasticity of −2 may not be appropriate for very large decreases in price faced by this group. For example, a 50 percent credit would lower the price from 0.80 to 0.50, a reduction of 37 percent. A price elasticity of −2 would imply an increase in giving from $300 to $768, that is, from a net cost of $240 to a net cost of $384. While this cannot be excluded as impossible, it may be larger than is likely. It is not possible to learn how the elasticity might change outside the range of current and past experience for this group.

Fortunately, however, the current estimates are appropriate for the analysis of the policies that are more likely. The extension of the charitable deduction to non-itemizers, or the availability of an optional credit at 25 or 30 percent, are well within the range of experience that we have studied. The current estimates therefore have important policy implications: Tax incentives to encourage giving by low- and middle-income households would induce a substantial increase in the flow of funds to charitable organizations.

Acknowledgements

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Footnotes

1. Henry Aaron, "Federal Encouragement on Private Giving," in *Tax Impacts of Philanthropy* (Princeton, N.J.: Tax Institute of America, 1972); William Andrews, "Personal Deductions in an Ideal Income Tax," *Harvard Law Review*, 86:2 (December 1972) pp. 309-385; Boris Bittker, "The Propriety and Vitality of a Federal Income Tax Deduction for Private Philanthropy," in *Tax Impacts on Philanthropy* (Princeton, N.J.: Tax Institute of America, 1972); Harry Kahn, *Personal Deductions in the Federal Income Tax* (Princeton, N.J.: Princeton University Press, 1960); Stanley Surrey, *et al., Federal Income Taxation* (Mineola, N.Y.: The Foundation Press, Inc., 1972); Michael Taussig, "Economic Aspects of the Personal Income Tax Treatment of Charitable Contributions," *National Tax Journal*, 20:1 (March 1967), pp. 1-19; William Vickrey, "Private Philanthropy and Public Finance," mimeo, 1973.

2. This refers to gifts of cash or or depreciated property. Gifts of appreciated property have a lower net cost because no tax is paid on the appreciation.

3. Martin Feldstein, "The Income Tax and Charitable Contributions: Part I - Aggregate and Distributional Effects," *National Tax Journal*, 28:1 (March 1975), pp. 81-99; Feldsten, "The Income Tax and Charitable Contributions: Part II - The Impact on Religious, Educational and Other Organizations," *National Tax Journal* (forthcoming), 1975; Feldstein, and Charles Clotfelter,

"Tax Incentives and Charitable Contributions in the United States: A Microeconometric Analysis," *Journal of Public Economics* (forthcoming), 1974; Feldstein, and Amy Taylor, "The Income Tax and Charitable Contributions: Estimates and Simulations with the Treasury Tax Files," Harvard Institute of Economic Research Discussion Paper Number 409, April 1975.

4. Feldstein and Clotfelter, op. cit.

5. The survey is discussed in James N. Morgan, Riachard F. Dye, and Judith H. Hybels, "Results from Two National Surveys of Philanthropic Activity," paper prepared for the Commission on Private Philanthropy and Public Needs. A second related survey of high-income individuals was also conducted but is not used in this study.

6. Our preferred specification yields a price elasticity of −2.7 and income elasticity of 0.8 at mean values of the independent variables. See Michael J. Boskin, "Estate Taxation and Charitable Bequests," *Journal of Public Economics* (January 1976, forthcoming), for a discussion of this procedure in the analogous estate tax case.

7. Even this overstates the importance of property gifts since the 4 percent also contains the carry-forward of previous gifts in excess of the limit. An extremely small fraction of taxpayers with incomes below $30,000, less than 1 percent, are affected by this limit.

8. The bracket intervals correspond to the brackets by which the *Statistics of Income* reports tax information: units of 1-2, 2-4, 4-8, 8-10, 10-15, 15-20 and 20-30 thousand dollars.

9. Feldstein and Clotfelter, op. cit., found that higher net worth did increase charitable giving (for fixed levels of income and price) but that the inclusion of a net worth variable did not alter the estimated price elasticity.

10. Feldstein and Clotfelter, op. cit.

11. Felstein and Taylor, op. cit., section 4, explain why the data for 1970 itemized tax returns is not rich enough to provide an unconstrained price elasticity. There is too little independent variation in price and income for this group.

12. Feldstein, op. cit; Feldstein and Clotfelter, op. cit.; Feldstein and Taylor, op. cit.

13. For any given hypothetical value of the difference in giving between itemizers and non-itemizers, we can calculate the power of our test. For reasonable values of this difference, the power of our test is quite large, i.e., it is very unlikely that we are accepting an incorrect hypothesis.

ESTATE TAXATION AND CHARITABLE BEQUESTS

Michael J. Boskin†

Introduction

Charitable bequests in the United States amount to well over two billion dollars.[1] Especially when combined with lifetime charitable contributions,[2] this voluntary giving accounts for a substantial share of the total resources devoted to the educational, health, scientific, cultural, religious, and welfare sectors of the U. S. economy. The amount and composition of such bequests are affected by the rate structure and deductibility of charitable bequests under the estate tax. This paper is devoted to an attempt to estimate the effects of the estate tax on charitable bequests.[3]

The estate tax[4] affects private philanthropy in several interrelated ways. First, and most obvious, consider the disposition of the estate at the time of death. Once debts and expenses are subtracted from the gross estate, the remainder, the economic estate, is divided among bequests to heirs, charitable bequests, and taxes. Since there is a $60,000 exemption and a marital deduction of one half of the estate,[5] the tax applies only to the wealthiest 7 percent of estates.[6] For this group, the tax and deductibility have two effects: First, the tax reduces the estate available for division between heirs and charity;[7] second, deductibility lowers the price of giving to charity relative to giving to noncharitable donees. For an estate with a marginal tax rate of μ, the price of bequeathing another dollar to charity rather than to noncharity heirs is $1-\mu$, since $\$\mu$ in taxes are saved by doing so. The first, or wealth, effect reduces charitable (as well as other) bequests, while the second, or price, effect increases charitable bequests.[8]

The progressive rate structure of the tax implies that both the wealth and the price effect increase with estate size.[9] It is well known that the composition of lifetime charitable contributions and of charitable bequests by type of donee varies markedly as wealth increases. The extremely wealthy contribute a smaller proportion of their total charitable contributions to religious organizations than to educational, cultural, and social welfare organizations. Hence, the net effect of estate taxation on charitable bequests, and their composition by donee, depends upon the magnitudes of these wealth and price effects.

Next, consider an individual planning his estate during his lifetime. For our purposes, an individual has five potential uses of his wealth at this stage: (1) personal consumption, (2) transfers to relatives (or others) during his lifetime, (3) lifetime charitable contributions, (4) bequests to relatives, and (5) charitable bequests. At this stage, the estate tax may affect both charitable contributions during the lifetime – via substitution between giving during life and planned giving at death – and charitable bequests – via substitution between lifetime expenditures and increasing the size of the estate.[10]

Finally, consider the disposition of noncharitable bequests by the estate's heirs. The estate tax reduces the after-tax wealth received by these heirs; some fraction of this decrease may have been destined, ultimately, for charitable contributions or for charitable bequests.

While proposals for reform of the estate tax are numerous, no changes have been made in the tax in over two decades. The last presidential election campaign indicated that there was little support for an increase in rates. Nor does integration with the gift tax appear likely in the near future. For our purposes, perhaps the most relevant policy options relate to the restriction, or abolition, of the charitable bequest deduction. Proposed changes range from placing a ceiling on the deduction through replacing the deduction by a flat-rate credit to outright elimination of the charitable bequest deduction. Also potentially relevant, of course, are changes in the income, and the gift, tax.

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The interaction of the estate tax with the gift tax and the income tax in a model of lifetime utility maximization is discussed in more detail in Chapter I.

While the data required to estimate the full model are unavailable,[11] we can estimate the effects of the estate tax on the allocation of estates between charitable and noncharitable bequests treating estate size as exogenous. These estimates are based on data from samples of individual estate tax returns from 1957-59 and 1969. A description of these data, a brief survey of previous studies on this topic, and a discussion of some special estimation problems are presented in Chapter II.

The basic empirical results – estimates of charitable bequest equations – are reported in Chapters III and IV. These sections deal with the 1957-59 data and the 1969 data, respectively. In each case, we report results of alternative formulations of the basic equations and alternative definitions of the key variables.

These results are then used both to evaluate the efficiency of deductibility – the additional charitable bequests induced per dollar of foregone tax revenue – and to simulate the effect of changes in the tax laws on charitable bequests. These estimates are presented in Chapter V.

The estimates of the price elasticity of charitable bequests generally exceed one, suggesting that the deduction increases charitable bequests by more than it decreases tax revenue.

Proposed changes in the treatment of charitable bequests which substantially increase the price of giving to charity, especially by the very wealthy, would result in a substantial reduction in charitable bequests; this reduction would come at the expense of the education, health, and welfare sectors of the economy.

Since the available data are far from ideal for the problem at hand, certain caveats, in addition to a summary and conclusion, are presented in Chapter VI.

I

A MODEL OF LIFETIME CHARITABLE CONTRIBUTIONS AND CHARITABLE BEQUESTS

Consider a model of individual utility maximization in which utility is derived from consumption during the lifetime, C_L, gifts to relatives and friends during the lifetime, g_L, lifetime charitable contributions, CH_L, and bequests to relatives or friends, g_D, and to charity, CH_D.

We represent the estate planners' preferences over these commodities by a utility-function of the usual type:[12]

$$U(C_L, g_L, CH_L, CH_D, g_D). \tag{1}$$

The estate planner faces the usual type of budget constraint relating expenditures to wealth:

$$P_{CL}C_L + P_{gL}g_L + P_{CHL}CH_L + P^f_{GD}g_D + P^f_{CHD}CH_D \leq K_O + WH \tag{2}$$

where K_O is initial assets, WH is work income,[13] and P_i is the price of commodity i. The superscript f refers to the forward price[14] of the commodities "purchased" at death.

Note that the size of the estate (in present value terms) bequeathed, E, is simply the portion of wealth not spent in the lifetime:

$$E = K_O + WH - (P_{CL}C_L + P_{GL}G_L + P_{CHL}CH_L). \qquad (3)$$

The size of the estate thus depends upon initial assets, labor income, and spending and saving decisions during the lifetime.[15]

We assume that the "estate planner" maximizes utility subject to the budget constraint. This produces the usual maximization problem:

$$\max \mathcal{L} = U(C_L, g_L, CH_L, CH_D, g_D) + \lambda\,(K_O + WH - P_{CL}C_L - P_{gL}G_L - P_{CHL}CH_L - P^f_{GD}G_D - P^f_{CHD}CH_D). \qquad (4)$$

Differentiating (4) with respect to each commodity yields the first-order necessary conditions for a maximum:

$$\begin{aligned}
\frac{\partial \mathcal{L}}{\partial C_L} &= \frac{\partial U}{\partial C_L} - \lambda P_{CL} = 0\\
\frac{\partial \mathcal{L}}{\partial G_L} &= \frac{\partial U}{\partial G_L} - \lambda P_{GL} = 0\\
\frac{\partial \mathcal{L}}{\partial CH_L} &= \frac{\partial U}{\partial CH_L} - \lambda P_{CHL} = 0 \qquad (5)\\
\frac{\partial \mathcal{L}}{\partial G_D} &= \frac{\partial U}{\partial G_D} - \lambda P^f_{GD} = 0\\
\frac{\partial \mathcal{L}}{\partial CH_D} &= \frac{\partial U}{\partial CH_D} - \lambda P^f_{CHD} = 0
\end{aligned}$$

$$\frac{\partial \mathcal{L}}{\partial \lambda} = K_O + WH - P_{CL}\,C_L - P_{GL}G_L - P_{CHL}CH_L - P_{GD}G_D - P_{CHD}CH_D = 0.$$

Taking the ratio of pairs of these necessary conditions we obtain

$$\frac{\frac{\partial U}{\partial G_L}}{\frac{\partial U}{\partial CH_L}} = \frac{P_{GL}}{P_{CHL}}\text{; and}$$

$$\frac{\frac{\partial U}{\partial G_D}}{\frac{\partial U}{\partial CH_D}} = \frac{P^f_{GD}}{P^f_{CHD}} \tag{6}$$

The interpretation of these equations is the familiar one: the estate planner will allocate his resources so that the ratio of the marginal utilities of each pair of commodities equals their relative price. Note that, in general, these marginal rates of substitution depend upon the consumption levels of *all* of the commodities. Only in the restrictive case of additively separable utility between lifetime goods and bequests will we have the marginal rate of substitution between, say, G_L and CH_L (or G_D and CH_D) independent of G_D and CH_D (G_L and CH_L).

Let us turn now to a consideration of the prices of the different commodities. First, we take the price of personal consumption as numeraire, that is, $P_{CL} = 1$. The price of lifetime giving to charity is complicated by the special provisions of the income tax laws. Charitable contributions are tax deductible up to a maximum percentage of AGI. If contributions fall strictly within the limit, the price of giving a dollar to charity is $1-m$, where m_y is the marginal tax rate applied to lifetime income;[16] for lifetime contributions beyond the limit, the price is 1. The picture is complicated still further by contributions of appreciated assets; see Feldstein[17] for a discussion of this point. Consider next the transfer of resources to family or friends during the lifetime. A gift tax is payable on lifetime gifts beyond a certain amount and above a small annual exclusion. While much "gift" giving is undoubtedly unreported, for persons subject to the gift tax, the price of giving depends upon the rate structure of the tax. If we call the gift tax marginal tax rate m_g, a dollar of gifts produces only $1-m_g$ of gift *after-tax*. Hence the price of giving a dollar *after-tax*[18] is $\frac{1}{1-m_g}$.

Consider next the forward prices of bequests to charity and to family or friends. In order to provide a dollar of charitable bequests, an estate planner, facing an interest rate r[19] must forego $\frac{1}{1+r}$ dollars of lifetime consumption. Viewed another way, the estate planner must invest $\$\frac{1}{1+r}$ at a return r to yield $1 for charitable bequests. If an inflation is expected, with prices expected to increase at a rate ΔP_C,[20] the forward price equals $\frac{(1+\Delta P)}{1+r} P_{CL}$. Finally, the provisions of the estate tax (for persons with a taxable estate) alter the price of bequests. An additional dollar left to family or friends produces an after-tax inheritance of only $1-m_e$, where m_e is the marginal tax rate under the estate tax. Hence, the forward price of bequests[21] to family or friends is $\frac{(1+\Delta P)}{(1-m_e)(1+r)} P_{CL}$. These considerations are summarized in the following array:

$$P_{CL} = 1$$

$$P_{GL} = \begin{cases} \dfrac{1}{1-m_g} & \text{if gift tax applicable} \\ 1 & \text{otherwise} \end{cases}$$

$$P_{CHL} = \begin{cases} 1-m_y & \text{if charitable deduction limit not binding} \\ 1 & \text{if limit binding} \end{cases}$$

$$P_{GD} = \begin{cases} \dfrac{(1+\Delta P)}{(1-m_e)(1+r)} & \text{if estate taxable} \\ \dfrac{1+\Delta P}{1+r} & \text{if estate not taxable} \end{cases}$$

$$P_{CHD} = \frac{1+\Delta P}{1+r}$$

Substituting these expressions for the prices back into (4), applying the income tax to earnings and interest income,[22] and solving the resulting first-order conditions yields the following system of demand equations:

$$C_L = f\left(K_O + (WH + rK_O)(1-m_y),\ \frac{1}{1-m_g},\ 1-m_y,\ \frac{1+\Delta P}{(1-m_e)(1+r)},\ \frac{1+\Delta P}{1+r}\right), \quad (7)$$

$$G_L = g\left(K_O + (WH + rK_O)(1-m_y),\ \frac{1}{1-m_g},\ 1-m_y,\ \frac{1+\Delta P}{(1-m_e)(1+r)},\ \frac{1+\Delta P}{1+r}\right),$$

$$CH_L = h\left(K_O + (WH + rK_O)(1-m_y),\ \frac{1}{1-m_g},\ 1-m_y,\ \frac{1+\Delta P}{(1-m_e)(1+r)},\ \frac{1+\Delta P}{1+r}\right),$$

$$G_D = i\left(K_O + (WH + rK_O)(1-m_y),\ \frac{1}{1-m_g},\ 1-m_y,\ \frac{1+\Delta P}{(1-m_e)(1+r)},\ \frac{1+\Delta P}{1+r}\right), \text{and}$$

$$CH_D = j\left(K_O + (WH + rK_O)(1-m_y),\ \frac{1}{1-m_g},\ 1-m_y,\ \frac{1+\Delta P}{(1-m_e)(1+r)},\ \frac{1+\Delta P}{1+r}\right).$$

We see immediately that the estate tax has four types of effects on philanthropy. It has a wealth effect on CH_D via decreasing after-tax estate size, an "own" price effect on CH_D (we expect the wealth effect of the tax to decrease CH_D, and the own-price decrease induced by the tax to increase CH_D), a "cross-price" effect on CH_L and indirect effects on the CH_L and CH_D of subsequent generations via the effects on G_L and G_D.[23]

We turn next to a discussion of the estimation of these effects.

II

A CURSORY DISCUSSION OF PREVIOUS STUDIES, ESTIMATION PROBLEMS, AND DATA

Previous Studies

There have been several attempts to infer something about the effects of estate taxation on charitable bequests from available data. Shaeffer[24] reports some simple tabulations from the Treasury Special Study of Estate Taxation (discussed in detail below). He notes the enormous difference in the type of charity favored by different size estates. Since no attempt is made to estimate wealth and price effects, his discussion of policy options is based on a series of assumptions regarding these key parameters.

Vickrey[25] attempts to infer something about the price elasticity of charitable bequests from the 1959 data. He calculates the net cost of charitable bequests as a percentage of the disposable estate and notes that this ratio rises with gross estate size. He concludes:[26] "On the whole, the evidence would seem to indicate that . . . demand for 'gross charity' has an elasticity smaller than one . . . while the deductibility may increase the gross amount of contributions, it does so by less than the tax relief granted." He goes on to question the wisdom of granting this tax relief from general funds, especially since the relief granted favors the wealthy disproportionately. It must be noted that Vickrey's analysis of the 1959 charitable bequest data obviously does not enable him to separate wealth and price effects. His inferences are not based on the estimation of demand relationships and his judgment concerning the price elasticity of demand for charitable giving is best viewed as a reasoned conjecture.

The only attempt to estimate a demand for charitable bequests relation is that of McNees.[27] McNees uses the 1959 Special Study data (see below) to estimate equations relating charitable bequests to wealth and price. He used economic estate and the marginal tax rate (rather than one minus the tax rate) to represent the wealth and price effect. His basic equation[28] is the following ordinary least squares regression (using only the data on estates with charitable bequests):

$$C = -101.2 + 30.4\,\mu + 12.25 \times 10^{-6}\,E^2$$

$$-312.5\,D - 184.1\,W + \ldots$$

where C is charitable bequests, μ is the marginal tax rate, E is economic estate, D is the number of categories of persons receiving bequests (his index of dependency) and W is a dummy variable for widows. Other variables appear in the equation, but they are not important for the discussion that follows.

Since the E^2 and μ variables have coefficients which are measured quite precisely, McNees concludes that "The model performs astonishingly well." As an introduction to the host of statistical problems involved in attempting to estimate the demand for charitable bequests, it is worthwhile to take a closer look at some of the implications of McNees' results.

Let us examine the predicted charitable bequests from McNees' basic equation for a few possible cases. McNees' estimates predict that estates bequeath *negative* amounts to charity![29] Consider, for example, a widow leaving funds to children, grandchildren, and brothers or sisters. Hence W = 1 and D = 3 in McNees' equation. The predicted values of charitable contributions for economic estates of $60,000, $100,000, and $1,000,000 are approximately -$1,223,000, -$683,000, and -$25[illegible],000, respectively!

Clearly, something is potentially severely wrong with the way McNees analyzed this body of data. Several obvious problems come to mind: ordinary least squares does not prevent the expected value of the dependent variable from being negative for particular values of the explanatory values, nor does it account for the piling up of the density at zero. Further, McNees uses only the observations for which charitable bequests are positive; he throws away the information in the bulk of the data.

Estimation Problems

There are a large number of potential difficulties in estimating the demand for charitable bequests. Among these are the constraints on the admissable value of charitable bequests (between zero and economic estate), the piling up of its density at zero, the lack of adequate data on lifetime income, wealth, and charitable contributions, the possible collinearity of price and wealth via the estate tax, the appropriate specification of the relation of charitable bequests by donee to total charitable bequests, the lack of information for estates not filing estate tax returns. The study by McNees amply illustrates the problems one may purchase with an incorrect specification. While some of these problems are insurmountable with available data, we shall attempt to be as careful as possible both in dealing with those potential problems which are solvable with available data and in pointing out how the other problems might affect our results. Hence, this subsection will discuss the problems briefly and indicate the actual estimation techniques used to produce the results reported below. A brief discussion of the possible (and unfortunately, unavoidable) biases in the results is found in Chapter VI.

The simplest way to organize all of these problems is to recall from equation (7) that charitable bequests are a function of after-tax wealth and four after-tax prices. An ideal body of data would provide information sufficient to measure accurately these six variables: charitable bequests, wealth, and the four prices. Unfortunately, no body of data exists that provides such information. The best data available, and in many respects they are quite good, contain no information on lifetime income; hence, wealth and the prices relating to lifetime gifts and contributions are not directly observable. Thus we are forced to adopt a specification which uses estate size as a substitute for wealth and which omits some price variables. This may render the estimated coefficients on wealth and the price of charitable bequests inconsistent. This potential specification bias is discussed in Chapter VI.

The same problem of inconsistent estimates may arise because estate size itself is endogenous. Again, we do not have information on wealth during the lifetime; there are no obvious variables which would seem to make good instruments for the application of instrumental variables. This problem is also discussed in Chapter VI.

There are several important econometric problems with which we can deal explicitly. First, consider the potential collinearity between the price of charitable bequests, p, and estate size, E. Since $p=1-\mu$, where μ is the marginal tax rate which in turn depends upon E, it might be difficult to separate out the separate effects of E and p on charitable bequests. Indeed, if p was an exact linear function of E, such a separation would be impossible. We have three factors in our favor in overcoming this problem: our large sample sizes, the nonlinearity in the tax schedules, and the wide tax brackets. We shall see below that these factors sharply reduce the correlation between E and p and enable us to estimate their separate effects quite precisely.

Two further problems that arise when we specify charitable bequests as a simple linear function of E and p are the restriction to single linear E and p effects and the simultaneity of p and CH_D. First, a simple linear relation between CH_D and p implies that a one unit rise in p has the same effect on the absolute level of CH_D throughout the range in p. This assumption is quite unrealistic and will be relaxed in several ways below.[30] Second, given E, the larger is CH_D, the smaller is the taxable estate and the marginal tax rate, and hence the higher is the price. Hence, there exists a relationship between the after-tax price of an *additional* dollar of charitable bequests and the estate size and charitable bequests. As with the omitted price variables, this creates a correlation between one of the explanatory variables and the error term in the regression. Hence, ordinary least squares estimates (potentially of all of the coefficients) will be inconsistent. In this case, fortunately, a natural instrument does exist: The price for the first dollar of bequests. This, of course, is highly correlated with the price for an additional dollar, but presumably uncorrelated with the error term. Thus, the results reported below all use this "imputed" price.

Perhaps the most serious estimation problem, and one that exists quite apart from which explanatory variables are included in the regression, is that CH_D must be non-negative and in the data piles up at zero. Some four out of five estate tax returns bequeath nothing to charity. Ordinary least squares takes none of these things into account. We saw from our discussion of McNees' results that his equation, based on applying ordinary least squares to the estates with charitable bequests, predicts inadmissable (negative or larger than E) values of CH_D for reasonable values of p and E .[31]

In view of the large concentration at zero, our desire for accurate estimates of coefficients and their standard errors and our interest in prediction (see Chapter V), we adopt the following truncated normal regression model:

$$CH_{Di} = \beta' X_i + u_i \qquad \text{if } \beta' X_i + u_i > 0$$

$$= 0 \qquad \text{if } \beta' X_i + u_i \leq 0$$

where CH_{Di} represents the charitable bequests of the i^{th} estate, the X_i are variables such as price and estate size, β is a vector of unknown constants and the u_i are independent $N(0, \sigma^2)$. Estimation of β and σ^2 proceeds according to the method pioneered by Tobin[32] and extended by Amemiya.[33] The estimates are consistent and asymptotically normal,[34] the conditional expectation, $E(CH_{Di}\,\beta'X)$, is necessarily non-negative, etc. It should be noted that while this procedure is clearly preferable in our case, its higher computational cost must be taken into account when deciding upon an appropriate estimation procedure.[35]

Two additional, and probably minor, problems remain. First, our samples are truncated in the sense that they include observations only on estates that filed tax returns. Estates of less than $60,000 are not required to file an estate tax return; indeed, over 9 out of 10 estates did not file one. There is, therefore, an unknown amount of charitable bequests accounted for by this group. Since charitable bequests are quite small and infrequent in the lower ranges of estate size among estates filing a return, the charitable bequests thus ignored are unlikely to be large relative to the total included. Further, extrapolation of results for the upper tail of the distribution of the remainder would be quite hazardous. One might therefore interpret the results reported below as conditional upon filing an estate tax return.

Finally, we are interested in charitable bequests by type of donee. We might choose to model charitable bequests to each donee as a separate commodity; or we could form some restrictions upon the coefficients across charitable bequest (by donee) equations to make them consistent with some aggregate charitable bequest equation. We adopt the former approach for convenience, since we have no strong prior beliefs to the contrary.

Having in mind these issues and our suggestions as to how to deal with them, we turn to a discussion of the data.

Sources of Data

The first source of data on individual estate tax returns used in this study is a sample of nearly 5,000 matched estate and gift tax returns collected in the Treasury Special Study of 1957 and 1959 Estate Taxation. These data are described in detail in Shoup.[36] We note that the sampling rate was 1 in 100 for estates with a gross estate under $300,000, 1 in 6 for those between $300,000 and $1,000,000, and 100 percent for those with gross estates over $1,000,000. These data contain information on estate size, charitable bequests, the composition of charitable bequests by type of donee, marital status, age, lifetime gifts to persons, and trusts.[37] They contain no information on the estates of other family members, nor do they contain information sufficient to identify state death tax rates.

Summary data for these returns are presented in Table 1; the mean values of selected variables are arranged by adjusted disposable estate class. A cursory examination of this table reveals a large variation in estate size, price, and charitable bequests in total and in composition by type of donee. For example, it is clear that the wealthier estates prefer bequests to education, social welfare, and "other" – the latter including closely held private charitable foundations. Estimates of charitable bequest equations based on these data are presented in Chapter III.

The second source of data on individual estate returns used in this study is a sample of over 40,000 federal estate tax returns filed in 1970.[38] The sampling rate was 100 percent for returns with gross estates over $300,000 and 24 percent for returns with gross estates under $300,000. By 1969, 7 percent of deaths resulted in the filing of an estate tax return.[39] These data contain information on estate size, charitable contributions, sex, age, and marital status of decedent, and so forth. *Unlike* the 1957-59 special study data, they do not contain information on type of charitable bequest donee, nor do they contain information on trusts. However, they do contain information on the asset composition of the estate. Further, the IRS has kindly provided me with information sufficient to approximate state estate and inheritance tax rates for each estate. This introduces substantial additional variation in prices and estate size.

Summary data for these returns are presented in Table 2; the mean values of selected variables are arranged by adjusted disposable estate class.[40] A cursory examination down the rows of Table 2 reveals considerable variation in prices, estate size, and charitable bequests.[41] Estimates of charitable bequest equations based on this data appear in Chapter IV. These estimates are quite similar to estimates based on the 1957-59 data. However, the larger sample size and more recent time period lead me to place greater reliance on the results from the 1969 data than on those from the 1957-59 data.

Definition of the Variables

Since the available data do not usually allow us to generate variables which conform precisely to our theoretical constricts, we have experimented with different definitions of the most important variables (wealth and price) and

Table 1

Mean Values of Selected Variables by Adjusted Disposable Estate Class[a]
1957–59

	[. . . . . . in thousands of dollars						. . . . . .]		
Adjusted Disposable Estate Class	Adjusted Disposable Estate	Economic Estate	Charitable Bequests	Religious	Education/ Scientific	Health/ Social Welfare	Other	Price for Add'l $ of Charitable Bequests	Price for First $ of Charitable Bequests
≤200	$103.7	$109.8	$1.3	$0.4	$0.2	$0.7	$0.0	$0.88	$0.85
200-500	323.4	390.5	5.8	1.7	1.5	2.6	0.0	0.70	0.68
500-1,000	761.8	988.9	28.3	4.8	8.3	13.6	1.5	0.65	0.64
>1,000	2,443.7	2,972.4	529.9	33.5	142.3	203.3	150.9	0.57	0.56

a. Adjusted disposable estate equals the gross estate less debts and expenses less the tax that would have been paid in the absence of any charitable contributions.

Table 2

Mean Values of Selected Variables by Adjusted Disposable Estate Class[a]
1969

Adjusted Disposable Estate ($000's)	Adjusted Disposable Estate ($000's)	Economic Estate ($000's)	Charitable Bequest ($000's)	Price for Add'l $ of Charitable Bequest
≤100	$68.6	$71.9	$2.6	$0.88
100-250	154.6	177.6	7.0	0.75
250-500	342.6	429.2	20.7	0.66
500-1,000	683.7	913.6	64.7	0.61
>1,000	2,045.0	3,370.0	573.2[b]	0.48

a. Adjusted disposable estate equals the economic estate less the taxes that would have been paid in the absence of any charitable contributions.

b. See footnote 40.

alternative functional forms. Fortunately, these alternative formulations produce similar results. The definitions of the variables used in this study are the following:

Charitable bequest. Any bequest qualifying for the charitable deduction. The donee types are self-explanatory. However, "other" includes many closely held charitable foundations of "general" purpose.

Wealth (estate size). Since we do not have any data on wealth, we used two measures of estate size: the economic estate (gross estate less debts and expenses) and adjusted disposable estate, the economic estate less the taxes that would have been paid in the absence of any charitable contributions. Note that the disposable (after-tax) estate equals the economic estate for those who bequeath everything (beyond allowable exemptions and deductions) to charity and equals the adjusted disposable estate for those who leave nothing to charity. Grossing up the estate to account for lifetime gifts produced no substantial changes in the results.

Price (of giving to charity). The price of a dollar of charitable bequests also is defined in two ways: the price that would have to be paid on an *additional* dollar bequeathed to charity and the price that would be paid on the *first* dollar bequeathed to charity. Since the price is equal to one minus the marginal tax rate, and since, for given estate size, the tax rate declines and price rises as charitable bequests increase, the simultaneity bias discussed above leads us to prefer the imputed price variable. For the 1957-59 data, the marginal tax rate is the federal rate. For the 1969 data, the marginal rate is the sum of the federal and state rates, adjusted for the deductibility of state against federal (and occasionally vice versa) taxes. Since state rates frequently vary by the relationship of the person receiving to the person providing the inheritance, the state rates used refer to spouses for married persons and children for non-married persons. No account is taken of the effect of tax postponement via use of trusts.[42]

Marital status. While the returns separate widowed, divorced, and single among the non-married, preliminary analysis suggested the married-not married distinction to be the only important one. Further, sex did not appear to be an important determinant of bequest behavior. Hence, only a married-not married distinction is maintained.

Age. Age is entered as a dummy variable separating younger individuals – probably including some whose deaths were not forseeable far in advance and whose estate planning may not have been well formulated.

Trust use. This variable appears in the 1957-59 regressions; in part, it is used to facilitate comparisons with McNees. Two uses are made of trust information: the percentage of noncharitable bequests made in trust form, and whether trusts were used.

Location. A dummy variable taking the value one for community property states, 1957-59 data only.

Asset composition. The 1969 data contain information on asset composition: stocks, bonds (by type), real estate, cash, insurance, notes, non-corporate business assets, and so forth. Complete disaggregation produced very mixed results: most coefficients were small and not measured very precisely. Aggregation into liquid assets, however, did produce some interesting results. Note, however, that the asset composition of the estate may also be endogenous and subject to the same problems as those discussed above for estate size.

With these definintions in mind, we turn to a discussion of the empirical results.

III

EMPIRICAL RESULTS: 1957-59 SPECIAL STUDY DATA

We report in this section some estimates of charitable contribution regressions applying the truncated normal regression technique described above to the 1957-59 Treasury Special Study data. We examine this body of data for three reasons: 1) to facilitate comparison with McNees' results; 2) to provide an independent set of estimates in addition to the 1969 results reported in Chapter IV; and 3) to provide some minimal information on compositional effects by type of donee.

The simplest possible demand relation includes only estate size and imputed price as explanatory variables. Results from this formulation – which was discussed earlier in Chapter II – are reported in Table 3. The coefficients appear to be estimated quite precisely.[43] The implied elasticities of giving with respect to estate size and price, calculated at mean values, are 0.46 and – 1.67 respectively. The potential collinearity between price and estate size is not important. The sample size of almost 5,000, the correlation between estate size and price of only about – 0.5, and the nonlinearity and wide brackets of the estate tax schedule all combine to enable us to estimate the separate price and wealth effects quite precisely.

McNees[44] used several explanatory variables in addition to estate size and a single linear price term. Table 4 reports the truncated normal regression using similar additional explanatory variables: whether or not married, an age dummy, a community property state dummy, trust use and percentage trusts and young with "dependent." Once again, virtually all of the coefficients are measured quite precisely. However, the introduction of the additional explanatory variables reduces the price elasticity to about -1.2 and slightly increases the estate size elasticity. Recall from our discussion above that including a possibly endogenous explanatory variable, such as trust use, may render *all* coefficients inconsistent.[45]

Table 3

Charitable Bequest Regression

	Coefficient of:[a]	Elasticity[b] of giving with respect to:
Economic estate	0.4420 (31.8)	0.459
Imputed price	-2773.54 (-48.6)	-1.67

a. Associated "t" statistics in parentheses.

b. Calculated at mean values.

Table 4

Charitable Bequest Regression

	Coefficient of:[a]	Elasticity[b] of giving with respect to:
Economic estate	0.4751 (31.0)	0.520
Imputed price	-1906.69 (-16.3)	-1.183
Not married	-814.43 (-10.5)	
Age <65	-442.99 (-4.4)	
Trust use	-114.99 (-2.9)	
Young with dependent	-624.71 (-2.4)	
Percentage trust	234.84 (1.8)	
Community property state	-293.98 (-2.9)	

a. Associated "t" statistics in parentheses.

b. Calculated at mean values.

It is instructive to compare our price and estate size elasticities obtained via the truncated normal procedure using all of the data with the elasticities implied in McNees' basic equation based on an ordinary least squares regression with just the non-limit observations. McNees' estate size elasticity is $(24.5 \times 10^{-6} \times E^2 / C)$. For an estate size of \$100,000, the implied elasticity is minute (.025 or so). The tax elasticity (the negative of the price elasticity) is $(30.4\ \mu / C)$. Again, it is unclear exactly how μ and C were entered in the basic equation. If μ is entered in decimal form and C in thousands of dollars, the implied price elasticity is close to unity.

However, this then implies a wealth elasticity of very close to zero. In all other cases the implied price elasticity is either zero (in which case the implied estate elasticities are on the order of 25 to 40) or an outrageously large 40 to 75 (again corresponding to a zero estate size elasticity). Hence, despite all the obvious shortcomings, the results in Table 4 at least are plausible.

Table 5 reports results of a regression identical to that just discussed, except that our alternate definition of wealth or estate size, adjusted disposable estate, is used. Again, the coefficients are measured quite precisely. The implied price elasticity at the mean is virtually identical, but the wealth elasticity is considerably larger, approximately unity.

Table 5

Charitable Bequest Regression
(1957-59)

	Coefficient of:[a]	Elasticity[b] of giving with respect to:
Adjusted disposable estate	0.560 (16.5)	1.051
Imputed price	-882.44 (-14.2)	-1.185
Not married	-520.74 (-4.3)	
Age <65	-204.45 (-7.3)	
Trust use	-134.39 (2.2)	
Young with dependent	-267.85 (-2.2)	
Precentage trusts	85.05 (3.7)	
Community property state	-171.64 (-3.5)	

a. Associated "t" statistics in parentheses.

b. Calculated at mean values.

The estimated coefficients of the other variables in the regression are measured somewhat less precisely than those of the income and price variables, but in most formulations are significantly different from zero by conventional tests. They suggest that persons dying before age 65, persons dying before age 65 with a dependent (revealed by a bequest to a spouse or child), those in community property states, and those not married bequeath less to charity than their counterparts with the opposite characteristics. The coefficients on trust use and percentage trusts suggest that the net effect of trust availability on charitable bequests is probably not large.

The picture differs considerably, however, when we adopt a less restrictive formulation of the price term in the regression. We noted in Chapter II that a simple linear dependence of charitable bequests on price is quite restrictive, for it implies that a unit change in the marginal tax rate is associated with the same absolute change in charitable bequests. In the truncated normal model, of course, the associated change depends not just on the expected bequest, given a bequest, but also on the probability of giving. Still, a single price term appears unduly restrictive. Hence, in Table 6 we present a regression with this restriction relaxed. We allow the price coefficient to vary over the range of price in three steps: less than 0.6, between 0.6 and 0.8, and greater than 0.8. A formal test of the hypothesis that the three price coefficients are equal may be made by the likelihood ratio test. We note that the statistic $-\ln\lambda$, the ratio of the maximum of the likelihood function over the restricted to the unrestricted parameter space, is distributed as χ_K^2, where K is the number of restrictions. In our case this number is a large multiple of the 5 percent critical value of the χ^2 distribution. Hence, we overwhelmingly reject the hypothesis of a single price coefficient.[46] The implied elasticities, calculated at mean values within price classes, are -0.9 for the lowest, -1.4 for the middle, and -1.8 for the highest price class. The corresponding wealth elasticity is about one half using adjusted disposable estate. Hence, easing up the restriction on the price effect has sharply reduced the wealth elasticity.

Table 6

Charitable Bequest Regression
(1957-59)

	Coefficient of:[a]	Elasticity[b] of giving with respect to:
Adjusted disposable estate	0.5932 (53.9)	0.540
Imputed price <.6	-1473.00 (-32.0)	-0.935
.6 < Imputed price <.8	-707.01 (-23.6)	-1.405
Imputed price >.8	-607.13 (-13.5)	-1.792
Not married	-505.11 (-17.5)	
Age <65	-157.95 (-4.4)	
Trust use	37.47 (2.5)	
Young with dependent	-217.43 (-2.3)	
Community property state	-23.93 (-0.7)	

a. Associated "t" statistics in parentheses.
b. Calculated at mean values.

Results of regressions similar to those reported in Table 6 for total contributions, that is, with price effects differing in the three ranges, are reported in Table 7 for regressions disaggregated by type of donee. Recall from Chapter II that several

Table 7

Charitable Bequest Regressions[a]
Disaggregated by Type of Donee

	Religious		Education/ Scientific		Social Welfare		Other	
Adjusted disposable estate	0.0155 (8.7)	[0.2]	0.1261 (14.3)	[0.4]	0.1905 (14.9)	[0.6]	0.608 (14.8)	[0.7]
Price < .6	-269.01 (-14.3)	[-0.7]	-1304.41 (-13.5)	[-0.7]	-1290.89 (-15.1)	[-0.7]	-9119.9 (-16.8)	[-1.8]
.6 < Price < .8	-263.54 (-19.5)	[-1.1]	-1549.39 (-21.7)	[-1.4]	-1326.77 (-22.1)	[-1.3]	-9547.3 (-21.8)	[-3.8]
Price > .8	-304.57 (-15.0)	[-2.0]	-1773.37 (-15.9)	[-2.4]	-1448.04 (-16.1)	[-2.0]	-9047.4 (-15.1)	[-5.2]
Not married	-133.92 (-10.3)		-358.51 (-5.3)		-459.1 (-8.1)		-803.4 (-2.0)	
<65	-63.48 (-3.8)		-379.82 (-4.1)		-327.13 (-4.4)		-431.2 (-0.8)	
Trust use	24.4 (3.7)		-9.58 (-0.3)		87.02 (2.9)		184.49 (0.9)	
Young with dependent	-93.58 (-2.0)		-426.84 (-1.7)		-249.77 (-1.3)		-186.75 (-0.2)	
Community property state	-68.88 (-4.1)		-74.93 (-0.9)		13.1 (0.2)		-0.839 (-0.1)	

a. Associated "t" statistics in parentheses; elasticities at mean values in brackets.

strategies were open to us in modeling the disaggregated regressions. In particular, we have chosen not to attempt to place constraints across equations forcing the disaggregate results to reproduce those for total contributions. We divide charitable bequest donees into religious, education/scientific, social welfare, and other. The results are extremely revealing. First, the wealth elasticity is around one half for education and social welfare. However, it is substantially lower for religious donations. This is consistent with the casual observation that total bequests increase more than proportionaely and also shift away from religious organizations as wealth increases. The price elasticities all follow the same pattern: they decrease substantially in absolute value as the price decreases. Leaving aside the other category, which includes many closely held private foundations, the price elasticities hover around minus two for those with low marginal tax rates (hence high prices), around minus one for the middle range, and somewhat below one for the highest tax, lowest price range. If these results are at all reliable, they suggest that the deductibility of charitable bequests stimulates at least as much giving to charity as revenue lost to the Treasury across the three major donee categories for the low and modest tax groups. The deductibility is less than fully efficient in this sense for the highest tax rate range if these results are correct. These elasticities may be used to simulate the relative impact of alternative tax law changes on bequests by type of donee.

For example, the wealth elasticities reported in Table 7 suggest that the tax law changes which decrease average tax rates, holding the marginal rate constant (for example, increasing the exemption while adjusting the brackets to retain the original marginal rates), will help education and social welfare proportionally more than religion.

We noted in Chapter II some crucial advantages of our second body of data: the 1969 estate tax returns. We turn now to a discussion of the empirical results from these data.

IV

EMPIRICAL RESULTS: 1969 DATA

We present in this section the estimates of charitable bequest equations derived from 1969 estate tax returns.[47] The results differ somewhat depending upon the exact formulation, but the estimated price elasticities are usually unity or larger for the low and modest price range and less than unity for the highest range. The estimated wealth elasticity is one half or less except for the wealthiest estates.

Table 8 presents estimates of charitable bequest equations comparable to those of Table 6. The measure of wealth is adjusted disposable estate, and three separate price coefficients are estimated over the price range. As in all of the results, all of the coefficients are estimated quite precisely. The wealth elasticity of 0.4 is of the same order of magnitude as the corresponding estimates for 1957-59. The price elasticities, evaluated at the mean values of estate size for each price class and for non-marrried persons over 65, differ markedly over the price range. The highest tax-lowest price group has an estimated price elasticity of -0.2. Demand appears to be quite inelastic for this group; we shall see below that a less restrictive representation of the price effect changes this conclusion. For the middle range of tax and price, the estimated demand elasticity is about unity. Finally, for the low tax-high price group, estimated demand is quite elastic. Note also that the collinearity between estate size and price does not appear to prevent precise estimation of the separate wealth and price effects. Again, wide brackets and non-linearity in the tax function plus the large sample size are more than sufficient to overcome this potential problem.

Table 8

Charitable Bequest Regression
(1969)

	Coefficient of:[a]	Elasticity[b] of giving with respect to:
Adjusted disposable estate	0.3262 (19.7)	0.40
Imputed price $<.6$	-347.06 (-3.9)	-0.20
$.6 <$ Imputed price $<.8$	-442.89 (-8.7)	-0.96
Imputed price $>.8$	-668.07 (-24.0)	-2.53
Married	-224.9 (-6.8)	
Age <65	-245.2 (-5.7)	

a. Associated "t" statistics in parentheses.

b. Calculated at mean values.

The two other explanatory variables included in the regression are dummy variables for married persons and persons dying before age 65. Married and younger persons both bequeath less to charity, *ceteris paribus*. The conjecture, of course, is that married and younger persons have more, and more dependent, dependents: spouses and younger children. The substitution of charitable bequests for bequests to heirs is likely to be greater the wealthier the heir and the more distant the relation. While no direct information is available on potential heirs and their own estates, we may conjecture that persons dying before age 65 on average have children in their twenties and thirties, whereas those dying beyond age 65 have children somewhat older and, on average, with somewhat higher current income. We shall deal further with the married-not married distinction below.

We noted the negative effect of being married on charitable bequests. It is worthwhile to explore this relationship still further. Hence, we ran a separate regression of the type reported in Table 8 on a subset of the data referring to married persons only. Again all coefficients appear to be measured quite precisely. (See Table 9.) The estimated adjusted disposable estate elasticity is virtually identical for the married group. However, the estimated price elasticities are all much larger in absolute value than for the population as a whole. A formal test of the hypothesis of no marital status effect on the three price coefficients was made using the likelihood ratio method comparing the equation reported in Table 8 [illegible] an equation with six price variables – the three price classes divided into married and non-married. This produced a χ^2 statistic many times the critical χ^2. Hence, it appears not only that married persons give less to charity, *ceteris paribus*, but that their charitable bequests are much more sensitive to the relative price of giving.

Table 10 reports estimates of an alternative way of varying the price (and this time also the wealth) effect over the range of price (wealth). We enter wealth and price linearly and also enter each multiplied by the corresponding natural logarithm. Recall from Chapter II that in the truncated normal model, the price (or wealth) effect equals the probability of giving a positive amount times the derivative of the

Table 9

Charitable Bequest Regression
(1969 - Married)

	Coefficient of:[a]	Elasticity[b] of giving with respect to:
Adjusted disposable estate	0.6261 (10.4)	0.44
Imputed price $<.6$	-2156.13 (-20.6)	-1.02
$.6<$ Imputed price $<.8$	-1818.53 (-26.1)	-2.24
Imputed price $>.8$	-1982.60 (-10.3)	-3.96
Age <65	-447.51 (-3.2)	

a. Associated "t" statistics in parentheses.

b. Calculated at mean values.

Table 10

Charitable Bequest Regression
(1969)

	Coefficient of:[a]	Elasticity[b] of giving with respect to:
Adjusted disposable estate	-1.083 (-8.6)	0.1
Estate x log estate	0.178 (13.1)	
Price	-1758.9 (-76.1)	-2.0
Price x log price	-2540.2 (-18.9)	
Married	-539.5 (-19.2)	
Age <60	-622.68 (-18.1)	

a. Associated "t" statistics in parentheses.

b. Calculated at mean values.

index function with respect to price (wealth). In this case the derivative is not just the price coefficient, but the coefficient on the sin[illegible] price term plus the coefficient on the p log p term multiplied by one plus log p. Hence, the price effect on the index varies over the range of p.

The estimated wealth elasticity is sharply lower at 0.1; the estimated price elasticity, at mean values, is −2.0, somewhat higher in absolute value than the previous specification.

We note that the likelihood ratio tests for each of these two sets of regressions of the hypothesis that there is only one linear price effect (and one linear wealth effect in the case of the regression reported in Table 10) is overwhelmingly rejected.

It is not just the price effect that may differ in different ranges. The wealth effect, too, may vary over the range of wealth. Hence, Table 11 reports estimates based on a formulation with four estate size variables and three price variables. Again, the individual coefficients are all measured quite precisely. The estimated wealth elasticities (evaluated at mean prices within each wealth class) increase with estate size. The elasticities for the two middle estate sizes are close to the estimate for the single elasticity reported in Tables 8 and 6. The smallest estates appear to have a somewhat lower wealth elasticity and the largest estates a substantially larger wealth elasticity than the middle groups. The three separate price coefficients also are measured very precisely. The pattern is the one we now expect: the elasticity decreases in absolute value as the price decreases. However, all three elasticities are larger by one half or more in absolute value than those reported in Table 8. The hypothesis of a single estate size coefficient conditional on three price coefficients is overwhelmingly rejected by the appropriate likelihood ratio tests.

Table 11

Charitable Bequest Regression
(1969)

	Coefficient of:ᵃ	Elasticityᵇ of giving with respect to:
Estate < 250,000	1.036 (5.3)	0.24
250,000 < Estate < 500,000	0.7399 (7.8)	0.37
500,000 < Estate < 1,000,000	0.654 (11.4)	0.57
Estate > 1,000,000	0.610 (42.2)	1.23
Imputed price < .6	-2036.61 (-23.8)	-0.69
.6 < imputed price < .8	-1739.17 (-30.8)	-1.69
Imputed price > .8	-1924.33 (-62.5)	-3.18
Married	-427.77 (-16.6)	
Age < 65	-601.32 (-17.3)	
% liquid assets	498.40 (16.7)	

a. Associated "t" statistics in parentheses.

b. Calculated at mean values.

The age and marital status dummies work in the expected direction once again.

In the regression in Table 11 we also include a variable reflecting the asset composition of the estate.[48] It appears the more liquid the estate, the larger the charitable bequest. However, the composition of the estate is likely to be endogenous and again we may be subject to an error in specification producing inconsistent estimates.

It is also instructive to note that since the brackets of the estate tax rate schedule are so wide we have a substantial variation in estate size for persons with the same marginal tax rate (and hence price). We performed some regressions within price classes of charitable bequests on estate size and dummy variables for marital status and age. This enabled us to "pick off" the wealth coefficient. The results were very similar to those reported in Table II.[49]

Finally, we report in Table 12 the results from the least restrictive formulation of the demand equations estimated. This formulation, in addition to allowing the four separate wealth effects, allows three separate nonlinear price effects. Within each of the three price classes, two variables are entered: price and price times the natural logarithm of price. This allows some curvature to the price effects and, unlike the results reported in Table 10, potentially allows this curvature to vary across the three price classes. Again, the coefficients are estimated quite precisely; the likelihood ratio test of the hypothesis that the coefficients of the three nonlinear price effects are zero is rejected at the usual levels of significance. However, the implied elasticities calculated at the mean values of the relevant variables are quite similar to those reported in Table 11: extremely elastic in the high-price, low-tax range; quite elastic in the middle range; and somewhat less than unit elastic in the low-price, high-tax range. As with the results reported in Table 10, the implied wealth elasticities are somewhat smaller, particularly for millionaire estates, than with the simpler formulation. When the percentage of liquid assets is included in the regression, the implied elasticities are quite similar.

Taken at face value, the estimates reported in this section and the previous one lend support to the argument that the charitable bequest deduction is efficient (in the sense of stimulating at least as much additional giving to charity as revenue lost by the Treasury). Recall, however, that we noted many problems relating to the specification of these relationships: omitted variables, the endogeneity of estate size, and so forth. We shall discuss these problems in more detail in Chapter VI. For now, we turn to an example of how the results may be used to simulate the effects on charitable bequests of tax law changes.

V

THE EFFECT OF ALTERNATIVE ESTATE TAX REFORMS ON CHARITABLE BEQUESTS

Suggestions on the appropriate role of death taxation are numerous.[50] The desirability of a deduction for charitable bequests (and for charitable contributions under the income tax) has been a much debated subject among economists and tax lawyers.[51] There are two major arguments against the deduction: It is allegedly inefficient and it is allegedly inequitable. While I disagree with both of these contentions for reasons soon to be stated, it is instructive to examine the arguments against the deduction. First, it is alleged that the deduction is inefficient because it loses more revenue for the Treasury than it produces for charity. This argument contains three potentially fallacious assumptions: That the price elasticity of demand for charitable bequests is less than one; that the elasticity of the tax base with respect to the rates is zero; and that the additional revenue could or would be

Table 12

Charitable Bequest Regression
(1969)

	Coefficient of:[a]	Elasticity[b] of giving with respect to:
Estate < 250,000	0.5452 (2.1)	0.29
250,000 < Estate < 500,000	0.2187 (1.7)	0.24
500,000 < Estate < 1,000,000	0.3159 (4.0)	0.40
Estate > 1,000,000	0.2881 (15.2)	0.54
Imputed price < .6	-1350.4 (-4.0)	-0.65
pinp (p < .6)	-2190.7 (-4.1)	
.6 < Imputed price < .8	-570.9 (-3.6)	-1.71
pinp (.6 < p < .8	-910.3 (-2.2)	
Imputed price > .8	-933.6 (-17.3)	-3.82
pinp 9 p > .8)	-3318.9 (-6.2)	
Married	-384.0 (-9.4)	
Age < 65	-225.2 (-5.2)	

a. Associated "t" statistics in parentheses.

b. Calculated at mean values (within corresponding classes).

dispensed as efficiently by the federal government as by thousands of private philanthropists. Little can be said about the third assumption except to note a curious disregarding of the economists' usual favorable disposition toward decentralization. Of the zero elasticity of the base with respect to the rate assumption, again little direct evidence is available to support or challenge this assumption. However, the assumption is clearly one extreme, and if there is any substitution from charitable bequests to lifetime consumption or charitable contributions (within the percentage of AGI limits) the usual estimates of foregone revenue are too large. Finally, we have presented above considerable evidence to suggest that for all but the exeptionally large estates, the price elasticity of demand is larger (in absolute value) than one. Hence, the Treasury foregoes less than the additional charitable bequests generated by the deduction even if we assume that the estate tax base would not shrink if the charitable bequest deduction were eliminated.

Second, it is alleged that the charitable bequest (and lifetime contribution) deduction is inequitable because it creates a different price for giving to charity for taxpayers with different tax rates, for the higher one's tax rate, the lower the price. A decedent with a *taxable* estate of two million dollars has a marginal tax rate of 49 percent; one with a taxable estate of fifty thousand dollars has a marginal rate of 25 percent. Hence, the price for giving an additional dollar to charity is half again as high for the latter as for the former. The deductibility of charitable bequests and contributions thus introduces an inequity among taxpayers. Such an argument is correct as far as it goes, but it ignores other dimensions of equity. First, it ignores the ultimate beneficiaries of the services of the philanthropic organization. It is clear that the consumers of the services of philanthropic organizations come from a much less well-heeled range of the wealth distribution, on average, than do those using the charitable bequest deduction under the estate tax. Second, a large amount of volunteer time, for example, a doctor working one day a month at a free clinic, results in the same differential government subsidization, since the foregone earnings would be taxable at rates depending upon income. To my knowledge, little public outcry can be heard demanding that volunteers for charity mail a check to the government for the foregone tax revenue on their foregone earnings. In this respect, the deduction equalizes the relative prices of leisure and giving to charity. Finally, equity also encompasses the effect of tax policies on the distribution of income and wealth. Feldstein[52] has shown that abolishing the income tax deduction for charitable contributions would make the post-tax-and-contribution distribution of income less equal. For the estate tax case, we are already dealing only with the extreme upper tail of the wealth distribution and abolishing the deduction will most likely increase the lifetime consumption of the extremely wealthy and result in larger inheritances for noncharity heirs. Worse yet, abolishing the deduction might decrease the savings rate for wealthy elderly persons. This would decrease future income, and if the elasticity of substitution in production is less than one, the share of this smaller income accruing to labor would fall. Hence, the primary objective of the estate tax, breaking up the concentration of wealth, might be dealt a severe blow.

Proposed changes in the charitable bequest deduction range from its abolition, through substitution of a flat-rate credit, to flip-flopping the progressive rate structure in granting the deduction. Many would favor a floor, and/or a ceiling, to the deduction. While all of these policies are amenable to analysis with the empirical estimates presented above, we shall, for present purposes, limit ourselves to a discussion of three policies: The abolition of the credit in favor of an across the board rate cut preserving the revenue yield of the tax,[53] a flat-rate credit replacing the deduction, and a ceiling of 50 percent of the estate on the deduction.

Based on my estimates from the 1969 data, abolition of the deduction would increase revenue to the Treasury by about $940 million.[54] The new, revenue preserving, rate schedule is thus approximately three fourths of the current one. The price of bequests is then increased to unity.

It is clear from Tables 11 and 12 that given the size of the price elasticities, the elimination of the deduction will sharply curtail bequests. For example, eliminating the deduction increases the price of bequests by approximately 50 percent for estates in the $500,000–$2,000,000 range. The estimated price elasticity for this group is −1.7. It is clear that raising the price to unity sharply curtails charitable bequests.

On the other hand decreasing the tax rates to three fourths of their original level decreases the tax by this percentage, but decreases the estate by a much smaller percentage (which, however, increases with estate size). Given the estimated wealth elasticities, it is clear that the increase in charitable bequests generated by the overall rate reduction will be far less than the decrease caused by eliminating the deduction.

We have estimated the aggregate decrease in charitable bequests due to elimination of the deduction and the decrease in the rates sufficient to retain revenue yield in the following way: For each estate we estimate its expected contributions given a price of unity and the lower tax rate based on the results of Table 12. We then sum the result and subtract this number from expected bequests with the current tax structure. We calculate the percentage decrease and apply it to the actual level of charitable bequests from 1969 estate tax returns.

The difference in expected charitable bequests from taxable returns, as reported in Table 13, is $1.1 billion; if we delete the "outlyer," the corresponding figure is about $0.8 billion. Thus, in aggregate, we estimate that abolition of the deduction in favor of an equal yield across the board rate reduction will cut charitable bequests on taxable returns by one half or more.

Table 13

The Effect of Alternative Policies on Charitable Bequests

(in millions of dollars)

	Abolish deduction/ rate reduction	Replace with 30% credit	50% ceiling[a]
Change in:			
Total charitable bequests	-1,100	-360	-189(-338)
Bequest to: religion	-152	-7	-19(-34)
education/science	-361	-164	-76(-136)
health/social welfare	-587	-191	-95(-170)
Tax revenue	0	+227	+43(0)
Loss to charity per dollar of additional revenue	–	$1.60	$4.40

a. Numbers in parentheses refer to change if the effect is to cut all the way back to exactly 50 percent of estate.

Of course, most returns which are not taxable will not be affected by the change; those returns which are not taxable due to charitable deductions will also cut bequests to charity. However, it is likely that aggregate bequests, taxable plus non-taxable, will fall by slightly more than charitable bequests on taxable returns alone.

Before turning to a discussion of the effects by type of donee, let us compare the effect of the abolition of the deduction on total charitable bequests with two other policies: Replacing the deduction with a flat-rate credit and imposing a ceiling of 50 percent of the estate on the deduction.

Replacing the deduction by a 30 percent flat-rate credit raises the price of charitable bequests for estates with marginal tax rates greater than 30 percent and lowers it for estates with marginal tax rates less than 30 percent. For all estates, the price is equalized at 0.7. Both because the price rise is not as large for large estates as with abolition of the deduction and because it is actually a price decrease for modest-sized estates, the indicated total decline in charitable bequests, while substantial, is not nearly so severe as with abolition of the deduction: $360 million, or one third of the corresponding figure for abolition of the deduction. The Treasury would gain approximately $227 million in additional revenue; hence, each dollar of additional revenue would lose charity about $1.60.

Finally, a 50 percent of estate ceiling on the deduction would affect those 2 percent of decedents giving more than 50 percent of their estate to charity. The total charitable bequests in excess of what would be allowed with a 50 percent ceiling is still a substantial amount, $338 million, about one sixth of charitable bequests. The predicted effect on total charitable bequests is to eliminate over one half of these bequests in excess of 50 percent of the estate, or $189 million. The Treasury would gain a slight amount, $43 million; hence, each dollar of additional revenue for the Treasury would lose charity $4.40.

It is also worth mentioning the probable effects of constructive realization of capital gains on charitable bequests. While our data do not include information on accrued capital gains, other sources[55] indicate that the very wealthy tend to hold a great deal of such gains until dealth. The effect of constructive realization on charitable bequests depends crucially upon whether assets bequeathed to charity are included in constructive realization. If they are, a wealth effect will decrease charitable bequests;[56] also, lifetime giving would be clobbered in the short run (if, as seems likely, constructive realization of appreciated property passing through as gifts to charity were also adopted). Once capital markets and individual portfolios adjust to this change we may expect far less saving in the form of accrued capital gains, and probably a decline in the size of net estates; this again implies a decline in charitable bequests. However, if assets bequeathed to charity are exempt from constructive realization, the picture is further complicated. At impact, such a policy would decrease the price of charitable bequests so long as accumulated capital gains exceeded planned charitable bequests. This would result in an initial increase in charitable bequests for such estates, in part or in toto offsetting the decrease in charitable bequests due to the wealth effect mentioned above. Again, individual portfolios and capital markets would adjust to the change to substitute away from accrued capital gains to other forms of saving and lifetime consumption, thus weakening the initial price effect. This policy is so often discussed that obtaining information on accrued capital gains in estate is almost as high a priority as matching lifetime giving with charitable bequests.

Another frequently discussed estate tax reform is to tax each estate just once per generation by allowing a 100 percent marital deduction. While no information exists following the disposition of estates within families, a few general qualitative conclusions may be drawn from our estimates concerning the effect of a 100 percent marital deduction on charitable bequests. For those decedents with a spouse, this policy would increase the price of charitable bequests relative to bequests to the spouse from $1-\mu$ to 1, where μ is the marginal tax rate (it would leave unaltered the price of charitable bequests relative to bequests to non-spouse heirs). From Table 9, we see that married persons are even somewhat more sensitive to price in determining charitable bequests than the whole population. Hence, for this group, the 100 percent marital deduction would reduce charitable bequests substantially. However, the increased bequests to the spouse might well show up as the subsequent charitable bequests of the spouse. Hence, at the very least, a 100 percent marital deduction will postpone charitable bequests until the death of the spouse. How much of the total decrease in charitable bequests will accrue ultimately to charity is difficult to say. Were a ceiling placed on the 100 percent marital deduction, say of $1,000,000, this price effect which is unfavorable to charitable bequests would be confined to modest-sized estates and would not affect the charitable bequests of the extremely large estates responsible for the bulk of charitable bequests. Such a policy also may be combined with a limit on the deductibility of charitable bequests, for example, the 50 percent limitation discussed above. The combined effect would be a substantial decline in charitable bequests.

Turning now to our attempts to estimate the effect of alternative estate tax reforms on charitable bequests to different types of donees, we immediately note several distinct problems. First, and most important, the only available data on charitable bequests by donee type are from the 1957-59 Treasury Special Study. We noted above several problems with this data. First, it is 15 years old. Second, there have been several changes in estate tax statutes since 1957-59; in particular, while the rates have not changed, the regulations concerning closely held private foundations have been changed substantially. A not insignificant amount of charitable bequests accounted for by the 1957-59 data made by the extremely large estates showed up in the "other" category, including a high proportion of "private other." It is very difficult to say how much of this type of charitable bequests is still occurring; further, a large share of these funds probably do wind up, eventually, as donated to one of the other categories: religion, education, science, culture, health or welfare. Finally, the sample size is much smaller for the 1957-59 data than for our 1969 data. The sampling rates are quite low for all but the millionaire estates in the 1957-59 data and this problem is exaccerbated by the fact that only one in five estates bequeath anything to charity. For all of these reasons, I place much more reliance on the 1969 estate tax return data, and my results therefrom, than the data from 1957-59.

With this in mind, we are faced with two potential strategies: We may estimate the effects of the tax reforms on charitable bequests by donee type from equations, such as those reported in Table 7 or the analog of that reported in Table 12, based on the 1957-59 data, and then build up the total effects by simply adding across donee types; or we may start from the 1969 aggregates and work our way down to the effects by donee type. If we adopted the former approach, it would be extremely cumbersome to obtain a precise consistency between the totals implied by summing the disaggregated results and that obtained using the estimates for total charitable bequests. While this is also the case if we adopt the latter method, the aggregate estimates from the 1969 data are the ones in which we have the most confidence. Hence, we approximate the effects of tax reforms by type of donee assuming the 1969 price effects hold for each donee type (recall from Table 7 this assumption appears valid) and that the 1969 wealth effects, adjusted by the ratio of wealth effects found for each type of donee in the 1957-59 data, hold. We also work with the distribution of giving by donee type found in the 1957-59 data; the other category is simply excluded – assigned to the remaining categories in proportion to their charitable bequests. This may result in a very slight overestimate of charitable bequests to education/science and health/welfare. The disaggregated results are rendered consistent with the total via an iterative procedure. Again, we have less confidence in the precise estimates by donee type than we do in the total; however, the qualitative picture is not changed at all by adopting alternative reasonable procedures.

The estimates in Table 13 reveal the story we expect based on the distribution of charitable bequests by donee type and the estimates of the price elasticities: The bulk of charitable bequests go to donees other than religion. This concentration increases dramatically as we move up the wealth scale. Since there are substantial price effects, policies raising the price of bequests to charity, especially to the very wealthy, sharply curtail charitable bequests to education/science and health/welfare; bequests to religion are affected only slightly.

For example, abolition of the deduction combined with a rate reduction has a predicted effect of reducing bequests to health/social welfare by over one-half billion dollars and to education/science by over one-third billion dollars. The latter is approximately the size of total lifetime giving under the income tax. Replacing the deduction with a flat-rate 30 percent credit would also curtail, if our results are accurate, bequests to education/science and health/welfare substantially. Since the price increase is less severe for the wealthy and there is actually a decrease for the smaller estates subject to tax, who favor religion relatively more heavily than wealthier estates, religion essentially breaks even under this proposal. Finally, the 50 percent of estate ceiling provision, which affects a small number of primarily wealthy estates, would probably also decrease charitable bequests to the non-religion categories by large amounts.

In brief summary, these policies which raise the price of charitable bequests to the wealthy will substantially curtail charitable bequests. This decrease will come almost exclusively at the expense of the education/science and health/welfare sectors.

While other policy options are under discussion, the moral of the story is clear: A large increase in the price of charitable bequests for the group giving most to charity – the extremely wealthy – is likely to cause a sharp decline in charitable bequests.

We turn now to a brief conclusion.

VI

CAVEATS AND CONCLUSIONS

Taken at face value, our results indicate that over a wide range of the estate size range, charitable bequests are quite sensitive to the price reduction created by their deductibility. Defining the efficiency of deductibility in the usual way–the ratio of the induced charitable bequests to the revenue loss to the Treasury (assuming a zero elasticity of the estate tax base with respect to the rate)–it appears that deductibility is at least fully efficient for the small- and modest-sized estates in the group filing returns. Only for the largest estates does deductibility appear to be less than fully efficient. We note, however, that the largest estates are responsible for a disproportionate share of total charitable bequests.

Throughout Chapters II, III, and IV we warned the reader that the unavailability of sufficient data on lifetime economic activity introduced certain potential biases into our estimates. It is worthwhile pausing for a moment to examine the possible direction and magnitude of these effects. The simplest way to explain these potential biases is to discuss them in terms of a linear model corrresponding to equation system (7).[57] Recall from that discussion that charitable bequests are a function of wealth, the relative price of charitable bequests, and other prices. Recall also from our discussion in Chapter II that no data are available simultaneously on charitable bequests and the relative price of charitable bequests, on the one hand, and the corresponding lifetime variables: wealth and the relative prices of gifts and lifetime charitable contributions.[58]

Roughly, then, we are regressing CH_D on E and P_{CHD} when we should be regressing CH_D on wealth, P_{CHD}, P_{gL}, P_{CHL}, and P_{CL}.

We thus have omitted several variables and used a proxy for another.

Suppose, for example, the wealth variable is properly specified; then omitting the "cross-price" variables yields expected price and estate size coefficients:

$$E\ (b_{PCHD}) = \beta_{PCHD} + \alpha_{PCL}\,\beta_{PCL} + \alpha_{PGL}\,\beta_{PGL} + \alpha_{PCHL}\,\beta_{PCHL}$$

$$E\ (b_E) = \beta_E + \gamma_{PCL}\,\beta_{PCL} + \gamma_{PGL}\,\beta_{PGL} + \gamma_{PCHL}\,\beta_{PCHL}$$

where the β's are the true coefficents and the α's and γ's are the coefficients which would be obtained from the auxiliary regressions[59] of the excluded variables on the included ones. Thus, any biases will depend upon the correlation between the included and excluded variables and upon the true coefficients of the excluded variables.[60]

Unfortunately, we have little to guide us about the sign of the potential bias. Economic theory tells us very little about cross-price effects. Further, we are uncertain as to the sign of the auxiliary regression coefficients; the obvious correlation among the prices is complicated by the presence of estate size as an additional regressor in the auxiliary equations.

Further, we usually expect that cross-price effects are not large relative to direct price effects. In addition, the true coefficients of the excluded prices may not all be of the same sign. All of these factors tend to make me believe that the sum of the effects making up the bias of the price coefficient may not be too large relative to the true coefficient. The most pressing problem is to obtain some evidence on substitution between lifetime charitable giving and charitable bequests.

A similar argument may be made for the bias in the wealth coefficient. The β's may be small and of opposite sign. Hence, we are unsure as to the direction of bias and doubtful the bias is large.

Similar reasoning may be applied to the misspecification of the wealth term.

With this discussion in mind, it is perhaps best to conclude with a word of caution. I have my doubts as to the magnitude of these biases; perhaps subsequent work with better data will conclude that estimates presented above are too elastic. However, until better data become available, it would be wise not to base public policy upon the assumption that the price elasticity of charitable bequests is quite small.

Acknowledgements

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Footnotes

1. American Association of Fund-Raising Counsel (1973). Based on 1969 estate tax returns; hence, excluding charitable bequests by estates not required to file an estate tax return.

2. Lifetime contributions amount to another $17 billion; three fourths of this total went to religion. Hence, annual charitable bequests to education, science, health, culture, and welfare organizations amount to about one half of the corresponding lifetime charitable contributions.

3. Charitable bequests are also (potentially) affected by the income tax and the gift tax. See Chapters I and VI.

4. We speak here of the federal estate tax. The effects of state estate and inheritance taxes are analogous to those of the federal estate tax. See Chapter IV.

5. If less than one half of the estate is transferred to the spouse, the marital deduction is limited to the actual transfer.

6. U.S. Internal Revenue Service (1972), p. 1.

7. This is strictly true so long as charitable contributions are less than the amount by which the economic estate exceeds the marital deduction plus specific exemption.

8. Under the usual assumptions of demand theory.

9. Unless the marginal propensity to bequeath to charity is at least unity.

10. Thus, the estate tax may affect saving and/or work effort. If it affects capital accumulation, it will also affect real income per capita in the long run. If charitable contributions are at all income elastic, contributions will also be affected in this way.

11. We would need data on lifetime charitable contributions, wealth, earnings and transfers at death for the *same* individuals.

12. There are alternative ways of modeling lifetime contributions and bequests. For example, we could take utility to be the discounted stream of instantaneous utilities over the lifetime, plus a utility of bequest:

$$U = \int_0^T e^{-rt} u(c_t, G_t, CH_t)dt + V(G_T, CH_T)$$

and maximize this subject to a budget constraint relating expenditures to wealth. Such a model is primarily useful in deriving implications about the patterns of c_t, CH_t and G_t over the life-cycle. Since we do not have any data on CH_t for the same families over the life-cycle, such a formulation would have to be implemented with cross-section data on individuals at different ages. Data on CH_t *by year and* CH_T for the same families are not available.

Another way of modeling the problem would be to adopt a two period utility function: $u(C_L,\ CH_L,\ G_L) + V(CH_D,\ G_D)$. The separability restriction will be discussed in detail below.

13. We treat lifetime earnings as exogenous for our purposes. Of course, estate taxation may also affect labor supply behavior.

14. The forward price of a commodity is the price that would have to be paid in the present for delivery of a commodity at some point in the future. For our purposes the estate planner may simply buy bonds delivering the required amount of money in the future.

15. Alternative conjectures on the effect of estate taxation on E are discussed in S. Fiekowsky, "On The Economic Effects of Death Taxation In The United States," unpublished Phd.D. thesis, Harvard University, 1959, and R. Musgrave, *The Theory of Public Finance*, (McGraw-Hill, 1959).

16. Of course, over the life-cycle, as income varies, so does m_y. We may think of m_y as either some averaging over rates over the life-cycle, or as a flat rate tax used to illustrate our point.

17. M. Feldstein, "On The Effects of The Income Tax Treatment of Charitable Contributions: Some Preliminary Results," Discussion Paper No. 337, Harvard Institute of Economic Research, 1974.

18. We assume throughout that decisions are based on real, after-tax values.

19. This interest rate reflects the compounding of shorter period rates over many periods. It is quite likely to be on the order of 3 or more with modest annual interest rates and modest time horizons.

20. The expected inflation rate may differ by commodity. Someone planning to give to a hospital may account for the higher inflation rate in medical services than in general consumption.

21. Strictly speaking, this applies only to additional bequests beyond the specific exemption and the marital deduction. For bequests to grandchildren and others involving generation skipping, the postponement of tax by the use of trusts complicates matters considerably. See G. Jantscher, *Trusts and Estate Taxation*, Brooking Institution, 1966.

22. Again, we use a flat rate tax for illustrative purposes.

23. The direct effects on G_L and G_D plus any indirect effects via changes in work effort or saving behavior. Of course, these second-round effects are discounted at an appropriate interest rate. Hence, the most important are probably those generated through surviving spouses.

24. J. Shaeffer, "Philanthropic Contributions: Their Equity and Efficiency," *Quarterly Review of Business and Economics*, 8:2 (Summer 1968), pp. 25-34.

25. W. Vickrey, "One Economist's View of Philanthropy," in F. Dickinson, ed., *Philanthropy and Public Policy*, NBRR, 1962.

26. Vickrey also discusses the income tax treatment of charitable contributions. His conclusion appears to be a summary judgment pieced together from data on both bequests and lifetime giving.

27. S. McNees, "Deductibility of Charitable Bequests," *National Tax Journal*, 26:1 (March 1973), pp. 79-98.

28. McNees also presents regression estimates disaggregated by type of donee and by estate size.

29. It is unclear from McNees' presentation whether the C and E variables are entered in dollars or, as they appear on the data tape, thousands of dollars. I have assumed that they are entered in thousands of dollars; McNees' equation predicts that large estates bequeath *substantially more than the full estate* to charity if the data are entered in dollars.

30. Martin Feldstein has stressed the importance of this restriction to me.

31. Least squares in this case causes other problems. See A. Goldberger, *Econometric Theory*, (New York: John Wiley and Sons, 1964).

32. J. Tobin, "The Estimation of Relationships for Limited Dependent Variable," *Econometrica*, 26(January 1958), pp.24-36.

33. T. Amemiya, "Regression Analysis When the Dependent Variable Is Truncated Normal," *Econometrica*, 4:6(November 1973).

34. If the relation is correctly specified.

35. Many other estimation strategies are possible. See Goldberger, op. cit.

36. C. Shoup, *Federal Estate and Gift Taxes*, Brookings Institution, 1966. Appendix A.

37. Also included was information on lifetime charitable contributions. However, these data are considered extremely unreliable. See Shoup, op. cit.

38. The bulk of these returns relate to death in calendar 1969. Separate analyses by date of death produced results similar to those reported below.

39. While this 7 percent of estates probably accounts for the bulk of charitable bequests, the amount bequeathed to charity by the remaining 93 percent (with gross estates less than $60,000) is not known.

40. There is one extremely large estate which bequeathed an enormous amount to charity. Whether this is a usual — or an exceptional — occurrence is difficult to judge. Separate results deleting the extreme upper tail of the estate size distribution produced results quite similar to those reported below.

41. These data are tabulated in more detail in U.S. Internal Revenue Service, Statistics of Income, 1969: Estate Tax Returns, 1972.

42. See Jantscher, op. cit.

43. All tables in this section refer to unweighted regressions. Regressions weighted by the inverse of the sampling rates produced similar estimates. Regressions weighted by the square root of estate size produced quite similar results. Grossing up estates to include lifetime gifts also made little difference. Convergence (defined as no changes up to the fourth decimal place in *any* coefficient) was normally achieved in 6 to 10 iterations. The "t-ratios," of course, are really asymptotically normal variables. Several other formulations of the equations are discussed in Chapter IV.

44. McNees, op. cit.

45. We shall discuss this in more detail in Chapter VI. For the moment, the reader is advised to exercise caution in the interpretation of these results.

46. Note that the hypothesis of a single price coefficient is *not* the same thing as that of a single price elasticity.

47. The comments of note 43, supra, apply to the 1969 data as well.

48. A regression including the different types of assets and debts produced mixed results, most coefficients not being measured very precisely, some with "wrong signs," etc.

49. It is worth noting that reestimating the equation reported in Table 11 deleting the returns with gross estates above $10 million produced results very similar to those reported in Table 10. The only major difference was a modest decrease in the wealth elasticity in the highest wealth class.

50. See R. Musgrave and P. Musgrave, *Public Finance in Theory and Practice,* (New York: McGraw-Hill, 1973); J. Pechman, *Federal Tax Policy,* 2nd ed. (New York: Norton, 1971); E. Rolph and J. Break, *Public Finance,* (Ronald, 1961); and Shoup, op. cit.

51. See W. Andrews, "Personal Deductions in an Ideal Income Tax," *Harvard Law Review,* 86:2 (December 1972), pp. 309-385; B. Bittker, "The Propriety and Vitality of a Federal Income Tax Deduction for Private Philanthropy," in *Tax Impacts on Philanthropy* (Princeton, N.J.: Tax Institute of America, 1972); P. McDaniel, "Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction," *Tax Law Review,* 27:3 (Spring 1972), pp. 377-413; S. Surrey, *et al., Federal Income Taxation* (Mineola, N.Y.: The Foundation Press, Inc., 1972); and Pechman, op. cit.

52. Feldstein, op. cit.

53. Under the zero elasticity of the base assumption; perhaps this is best viewed as a very short run balanced budget operation.

54. One huge estate made enormous lifetime gifts to charity, which were included in the estate and deducted. If we assume that these funds would have been in the taxable estate, the revenue yield would be larger than mentioned in the text. If we deleted this "outlyer" completely, we are probably incorrectly assuming that no super rich people die and leave everything to charity. Emil Sunley suggest that one such death a year is possibly too often. We assume one half of the charitable deductions would be taxable. Other assumptions would not drastically affect the results.

55. Eg., M. Bailey, "Capital Gains and Income Taxation," in A. Harberger and M. Bailey, eds., *The Taxation of Income from Capital,* Brookings Institution, 1969.

56. Note, however, that the capital gains tax would be subtracted from the estate and hence would be offset, in part, by a lower estate tax.

57. This discussion, of course, is only heuristic; it does save us the cumbersome task of discussing the much more complicated truncated normal analog.

58. We switch here to P_{gD} as numerarie.

59. H. Theil, Principles of Econometrics (New York: John Wiley and Sons, 1971).

60. Note that the same reasoning applies to a duscussion of estimating lifetime charitable contributions when the price of charitable bequests is excluded.

CHARITABLE BEQUESTS, ESTATE TAXATION, AND INTERGENERATIONAL WEALTH TRANSFERS

Martin S. Feldstein[†]

Introduction

Charitable bequests are an important source of support for nonprofit organizations and a significant factor in the dispersion of personal fortunes. In 1970 charitable bequests exceeded $2 billion or 10 percent of the total philanthropic gifts made by individuals.[1] Such bequests are particularly important for educational institutions, accounting for approximately 24 percent of all individual gifts.[2] A very substantial portion of the net value of large estates is contributed to charity. Among estates with a gross value in excess of $1 million in 1970, gifts to charitable organizations were more than 33 percent of the value of gifts to individuals. Among estates with gross value in excess of $5 million, charitable bequests were more than 125 percent of the value of gifts to individuals.

The current estate tax law excludes from the taxable estate all such charitable bequests. The tax law thus makes the "price" of charitable bequests less than the price of bequests to individuals.[3] More specifically, an individual with a marginal estate tax rate of 60 percent can bequeath $100 to charity by foregoing a bequest of $40 to his personal heirs; for him (or them) the net price of charitable bequests is only 0.4. Because the estate tax is very progressive, the net price of charitable bequests falls sharply as estate size increases.

This feature of the estate tax law raises three related questions: (1) Does the deduction of charitable bequests increase the total amount of such bequests or does it lower the taxes paid by the estates that make such bequests and thus merely increase the amount that is available for distribution to individual heirs? (2) If the deduction does increase total charitable bequests, are the extra bequests that are induced larger than the estate tax revenue that the Treasury foregoes because of the deduction?[4] That is, what is the efficiency of the charitable bequest deduction, the number of dollars of additional bequests induced per dollar of foregone revenue? (3) What is the effect of the deduction of charitable bequests on the net estates received by individual heirs? If the induced increase in charitable bequests is greater than the foregone revenue, individual heirs receive less than they would if the deduction were eliminated. But if the induced increase in charitable bequests is less than the foregone revenue, individual heirs are better off than they would be if the current deduction were eliminated.

The answer to all three questions depends on the elasticity of charitable bequests with respect to price. The primary focus of this paper will be on the estimation of this price elasticity. An estimated price elasticity that is not significantly different from zero implies that the current deduction does not increase charitable giving. In contrast, a significant negative price elasticity implies that charitable organizations do receive more than they would if the deduction were eliminated. If the absolute price elasticity is greater than one (that is, if the price elasticity is algebraically less than minus one), charitable organizations receive more in additional contributions than the Treasury foregoes in revenue. The absolute elasticity is itself a measure of the efficiency of the deduction, that is, the ratio of additional charitable bequests to lost tax revenue. It is also clear that an elasticity greater than one implies that the current deduction reduces the size of the net estate received by individual heirs; although the deduction reduces the taxes paid, charitable gifts are increased by more than taxes are reduced so that the net estate after taxes and charitable gifts is reduced. Obviously, a price elasticity less than one implies that the deduction increases the size of the net estate available for individual heirs.

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The evidence presented in this paper suggests that the price elasticity of charitable bequests is significantly negative and probably between minus one and minus three. This result is therefore quite consistent with Boskin's estimate[5] that the price elasticity is between minus one and minus two. This agreement is particularly reassuring because Boskin used a very different type of data and estimation method.

The current paper examines the sensitivity of the estimated price elasticity to alternative definitions of price and to alternative functional forms. Changing the measure of price has little effect on the estimated price elasticity. In contrast, the price elasticity is quite sensitive to the choice of functional form relating charitable bequests to price and estate size. In particular, a number of functional forms imply positive price elasticities over the entire range of estate sizes or a large part of that range. These unstable and unacceptable price elasticities must be borne in mind and regarded as a warning that these results may be subject to serious potential error. The evidence there is clearly not as strong as it was in previous studies of the effect of taxation on charitable gifts by living individuals.[6]

The data and the measurement of variables are discussed in Chapter 1. The basic parameter estimates are presented in Chapter 2. Separate estimates for large estates are developed in the third chapter. In Chapter 4, gifts to different types of donees are studied. There is a brief concluding section.

I

DATA AND MEASUREMENT

At irregular intervals the Internal Revenue Service published the value of charitable contributions in each gross estate class during a single recent year.[7] The current study uses a time series of these cross sections for the available years from 1948 through 1963.[8] With 15 gross estate classes,[9] the sample has 135 aggregate observations. Although there was no change in the estate tax rates during the sample period, the tax rate at every *real* level of gross estate has been increasing because of inflation. This source of variation reduces somewhat the collinearity between price and estate size that exists within a single year.

A variety of functional specifications relating charitable giving (G) to estate size (E) and a price (P) have been investigated. The most basic specification is the equation:

$$\frac{G_{it}}{E_{it}} = \alpha + \beta P_{it} + \gamma E_{it} + \epsilon_{it} \tag{1}$$

The subscript i denotes the gross estate size class and the subscript t denotes the year. The variable ϵ_{it} is an unobservable residual that reflects random disturbances and specification errors. The more general specifications described below allow the effects of estate size and price to vary with the levels of estate size and price.

The variable G_{it} is the average charitable bequest per return in gross estate class i and year t. The bequest is defined as the *gross* amount given by the individual estate to charity and not as the *net* cost of that contribution to the individual heirs. These amounts include the value of donated assets as well as gifts of money. Bequests are measured in constant 1957-59 dollars by deflating with the consumer price index. Of course, only those estates that file estate tax returns, that is, those with gross estates in excess of $60,000, are included in the sample.

The basic measure of estate size (E) used in this study has been gross estate minus all noncharitable deductions except the marital deduction. This measure assumes that the marital deduction takes priority in the individual's estate planning. Fortunately, a variety of other definitions of estate size, including gross estate minus noncharitable deductions, gross estate minus the tax liability if no charitable bequests were made, and gross estate itself yielded very similar estimates for the key price elasticity. In practice, the value of the E_{it} is the average real value of the estate per return in gross estate class i and year t, measured in constant 1957-59 dollars. Although the results are not sensitive to the available measures of estate size, it is clear that none of the available variables is an ideal measure of the decedent's economic situation. The value of previously created trusts and of gifts inter vivos, as well as the number and financial positions of the decedent's potential heirs, should all influence charitable giving.

The price variable (P) measures the estate's opportunity cost per dollar of charitable bequest in terms of foregone personal bequests to individual heirs. An estate with marginal tax rate m can choose between (1) contributing one dollar to charity and (2) having 1-m dollars for additional personal bequests to individual heirs. We therefore define the individual's price of charitable giving by P=1-m. In practice, P_{it} is measured by using the marginal tax rate for an estate with the average "taxable estate" in gross estate class i and year t. Two different measures of "taxable estate" and therefore of price have been used: P1 is based on the actual taxable estate plus charitable bequests and P2 on the actual taxable estate plus both charitable bequests and the marital deduction. Both measures yield the marginal tax rate for the first dollar of charitable bequest. This makes the price variable exogenous; using actual taxable estate would make the price variable depend upon the charitable bequest itself. The first measure of price assumes that the decedents choose their marital bequests before they decide on their charitable gifts while the second measure assumes that both decisions are made jointly.[10] Fortunately, there is little difference in the results corresponding to these different measures of price.

Contributions of appreciated assets create no special problem for measuring the price of charitable bequests. When an asset is bequeathed, either to an individual or to a charitable organization, its full value can be deducted from the donor's taxable estate and there is no constructive realization and therefore no income tax to be paid by the decedent or by the recipient. Assets gifts have the same price as cash gifts.

Estates are subject not only to federal estate tax but also to taxes levied by individual states. Because the federal government gives a direct tax credit for a portion of the state taxes paid, the two rates do not fully cumulate. To assess the importance of the state tax rates, the following calculation was performed for 1963. For each of the 15 published gross estate classes, an estate at the midpoint of the class was chosen. On the assumption that the full marital deduction is used and that the remainder is given to the decedent's minor children, the inheritance tax in each state for each size estate was calculated. The excess of this inheritance tax over the federal tax credit is the "excess state tax." Weighting the excess state rates by the number of estates in each size class and state yields the average excess state rate by size of estate. In every case, this average excess state rate was less than 1 percent. On the basis of this it was decided to ignore the state inheritance taxes.[11]

Table 1 presents the values of G_{it}, E_{it} and $P1_{it}$ for each gross estate class for 1963, the most recent year in the sample. For each estate class, the table also shows the ratio of gifts to the estate after all noncharitable deductions (column 5).

Each of the observations represented a different number of estate tax returns. In the very highest estate size classes, there are relatively few returns each year and substantial year to year variation in the ratio of bequests to estate size. Although the available data are not a sample but a report of all estates, one can regard each

Table 1

Charitable Bequests by Estate Size, 1963

Gross Estate Size Class (in $000's) (1)	Average Charitable Bequests (in $000's) (2)	Average Net Estate* (in $000's) (3)	PI (4)	Charity as Percentage of Net Estate* (5)
60-69	1.02	55.89	1.00	2.15
70-79	1.10	63.88	1.00	2.10
80-89	1.35	72.14	0.97	2.32
90-99	1.49	80.46	0.93	2.35
100-119	1.80	93.16	0.89	2.50
120-149	2.68	113.07	0.82	3.10
150-199	4.00	145.49	0.75	3.58
200-299	6.53	203.42	0.70	4.15
300-499	14.19	322.23	0.70	5.60
500-999	36.23	580.47	0.68	7.77
1,000-1,999	112.69	1,169.99	0.63	11.63
2,000-2,999	190.23	2,053.78	0.55	11.14
3,000-4,999	378.66	3,207.53	0.47	14.60
5,000-9,999	828.04	5,568.44	0.37	17.84
10,000+	3,409.98	15,582.48	0.23	27.99

*Estate value is measured by gross estate minus all noncharitable deductions. PI is based on taxable estate plus charitable bequests.

years's actual observation as a sample from the population of possible decedents. If the underlying microeconomic relations have constant variance, the process of averaging implies that the error variance will be larger for the observations based on a small number of returns. We have therefore weighted each of the observations by the square root of the number of returns represented by that observation.

II

EFFECTS OF PRICE AND ESTATE SIZE

Equation 2 presents the estimated parameters for a simple specification:

$$\frac{G_{it}}{E_{it}} = \underset{}{0.118} - \underset{(0.010)}{0.107}\ PI_{it} + \underset{(0.083)}{0.994} \cdot 10^{-8}\ E_{it} \qquad (2)$$

$$R^2 = 0.82$$
$$N = 135$$

The value of the estate is measured by the gross estate minus all deductions except charitable bequests and the marital deduction. The price P1 is based on the taxable estate plus charitable bequests. The ratio of charitable bequests to estate value is significantly related to both price and estate size. The equation provides a quite good explanation of the overall variation in the bequest ratio: $R^2 = 0.82$. Despite the potential problem of collinearity between estate value and price, the standard errors of the estimated coefficients are very small.

The specification of equation 2 implies that the price elasticity of charitable bequests varies with price:

$$\frac{dG}{dP}\,\frac{P}{G} = \frac{d(G/E)}{dP}\quad\frac{P}{(G/E)} = -0.107\quad\frac{P}{(G/E)} \tag{3}$$

The price elasticity has been evaluated for the average value of P and the corresponding value of G/E at four different sizes of the taxable estate. For taxable estates of $80,000, the average price in 1963 was 0.89 and the predicted ratio of charitable gifts to estate value was 0.022. This implies a local price elasticity of -4.04. By a similar calculation the price elasticity at $120,000 is -2.06, at $500,000 is -1.45, and at $5,000,000 is -0.31.

The very substantial changes in estimated elasticity may represent true behavioral differences but may also reflect only the restricted functional form. As Table 1 showed, the ratio of gifts to estate size rises very rapidly for large estates. The specification of equation 2 imposes a linear relationship which may distort the implied elasticities. As an alternative, equation 3 transforms the dependent variable so that changes in price and estate size cause proportional changes in the ratio of gifts to estate size:

$$\ln\frac{G_{it}}{E_{it}} = \underset{}{-0.989} - \underset{(0.16)}{3.18}\;P1_{it} + \underset{(0.14)}{0.38}\cdot 10^{-7}\;E_{it} \tag{4}$$

$$R^2 = 0.83 \qquad N = 135$$

The coefficients are again very significant and the overall explanatory power is quite high.[12] The corresponding elasticities are derived from:

$$\frac{dG}{dP}\cdot\frac{P}{G} = \frac{d(G/E)}{dP}\cdot\frac{P}{(G/E)}$$

$$= \frac{d\ln(G/E)}{dP}\cdot P \tag{5}$$

$$-3.18\;P$$

The specific elasticities are now -2.83 for a gross estate of $80,000, -2.39 for an estate of $120,000, -2.16 for an estate of $500,000, and 1.18 for an estate of $5,000,000.

There are of course other ways to generalize the specification of equation 2. Of particular importance is the potential nonlinearity in the effect of estate size. It seems reasonable to expect that an extra $1,000 of estate value will have a larger effect in small estates than in very large estates. This is confirmed by the estimates of equation 6.

$$\frac{G_{it}}{E_{it}} = 0.138 - \underset{(0.21)}{0.20}\ P1_{it} + \underset{(0.118)}{0.076}\ (P1)^2_{it}$$

$$+ \underset{(0.06)}{0.20} \cdot 10^{-7}\ E_{it} - \underset{(0.16)}{0.53} \cdot 10^{-15}\ E^2_{it} \tag{6}$$

$$R^2 = 0.88$$
$$N = 135$$

The price elasticity is now derived, by an extension of equation 3, from

$$\frac{dG}{dP} \cdot \frac{P}{G} = (-0.20 + 0.15\ P)\ \frac{P}{(G/E)} \tag{7}$$

The implied price elasticities vary substantially but at a lower level than in the simpler specification of equation 2: -1.96 at $80,000, -1.09 at $120,000, -0.69 at $500,000, and -0.11 at $5,000,000.

Unfortunately, other generalizations have conflicting implications. Equation 8 extends the previous specification by introducing a cross-product term between price and estate size. To prevent this term from being dominated by the very largest estates, the logarithm of estate size is used.

$$\frac{G_{it}}{E_{it}} = 0.096 - \underset{(0.18)}{0.56}\ P1_{it} + \underset{(0.10)}{0.16}\ (P1_{it})2$$

$$+ \underset{(0.05)}{0.17} \cdot 10^{-7}\ E_{it} - \underset{(0.14)}{0.36} \cdot 10^{-15}\ E^2_{it} \tag{8}$$

$$+ \underset{(0.004)}{0.029}\ P1_{it} \cdot \ln(E_{it})$$

$$R^2 = 0.91$$
$$N = 135$$

Each of the terms in this new specification is statistically significant but the elasticities, calculated from

$$\frac{dG}{dP}\ \frac{P}{G} = [-0.56 + 0.32\ P + 0.03\ \ln(E)]\ \frac{P}{G/E} \tag{9}$$

now have the wrong sign for all size estates: +1.50 at $80,000, +0.70 at $120,000, +0.54 at $500,000, and +0.18 at $5,000,000. Although these results are clearly unacceptable, they serve as a warning that the previous estimates may be more uncertain than their standard errors imply.

A specification similar to equation 8 but in semilogarithmic form also shows the importance of nonlinearities and of the interaction of price and estate size:

$$\begin{aligned} \ln \frac{G_{it}}{E_{it}} = {} & 1.75 - \underset{(2.55)}{22.12}\ P1_{it} + \underset{(1.43)}{7.90}\ (P1)^2_{it} \\ & - \underset{(0.07)}{0.16} \cdot 10^{-6}\ E_{it} + \underset{(0.19)}{0.42}\ 10^{-14}\ E^2_{it} \\ & + \underset{(0.06)}{0.76}\ P1_{it}\ \ln(E_{it}) \end{aligned} \qquad (10)$$

$$R^2 = 0.94 \qquad N = 135$$

Again the elasticities implied by

$$\frac{dG}{dP}\ \frac{P}{G} = [-22.12 + 15.80\ P1 + 0.76\ \ln(E)]\ P \qquad (11)$$

are positive and unacceptable: +2.01 at \$80,000 but +1.92 at \$120,000, +2.48 at \$500,000, and +2.00 at \$5,000,000.

The final specification to be considered is the simple constant elasticity relationship:

$$\ln G_{it} = -10.28 + \underset{(0.04)}{1.56}\ \ln(E_{it}) + \underset{(0.18)}{0.19}\ \ln P1_{it} \qquad (12)$$

$$R^2 = 0.99 \qquad N = 135$$

The price elasticity is insignificant and has the wrong sign, a further warning about the reliability of the semilogarithm elasticities. All attempts to generalize this specification by adding the squares and cross-product of ln P1 and ln E always resulted in the insignificance of all price terms and no improvement in the explanatory power of the equation.

Table 2 summarizes the parameter estimates for the linear and semilogarithmic equations. The corresponding elasticities are presented in Table 3. In general the results are less volatile and more plausible for the second form.

Each of the specifications has been reestimated using the alternative definition of price (P2) which is based on taxable income plus both charitable bequests and the marital deduction. The parameter estimates are presented in Table 4 and the corresponding price elasticities in Table 5. Comparing the R^2 values in Tables 2 and 4 shows that P1 has a greater explanatory power, that is, charitable bequests are generally determined after allowing for the marital deduction. The elasticities are similar in Tables 3 and 5 but the original values based on P1 are generally more reasonable.

III

BEHAVIOR OF LARGE ESTATES

The assumption that a single behavioral equation can represent both the small estates and the very large estates is of course a great simplification. Moreover, because of the weighting of observations the parameter estimates of Chapter II are heavily

Table 2

Effects of Price and Estate Size on Charitable Bequests: Price Measured by P1

Equation	Dependent Variable	Constant	P1	$(P1)^2$	E	E^2	P1·ln(E)	R^2
2.1	G/E	0.118 (0.008)	-0.107 (0.010)		$0.994\text{x}10^{-8}$ (0.083)			0.82
2.2	G/E	0.138 (0.088)	-0.200 (0.205)	0.076 (0.118)	$0.201\text{x}10^{-7}$ (0.057)	$-0.527\text{x}10^{-15}$ (0.159)		0.88
2.3	G/E	0.096 (0.075)	-0.563 (0.180)	0.161 (0.100)	$0.166\text{x}10^{-7}$ (0.048)	$-0.364\text{x}10^{-15}$ (0.136)	0.029 (0.004)	0.91
2.4	ln(G/E)	-0.989 (0.141)	-3.182 (0.164)		$0.375\text{x}10^{-7}$ (1.106)			0.83
2.5	ln(G/E)	2.831 (1.64)	-12.59 (3.81)	5.685 (2.201)	$-0.731\text{x}10^{-7}$ (1.106)	$-0.518\text{x}10^{-16}$ (29.60)		0.86
2.6	ln(G/E)	1.745 (1.06)	-22.12 (2.55)	7.904 (1.425)	$-0.163\text{x}10^{-6}$ (0.068)	$0.422\text{x}10^{-14}$ (0.193)	0.759 (0.056)	0.94

Price variable P1 is based on the taxable estate plus charitable bequests.
Standard errors are shown in parentheses.
All estimates refer to 135 observations from the period 1948 through 1963.

Table 3

Price Elasticities of Charitable Giving:
Price Measured by P1

	Estate Size			
Equation	$80,000	$120,000	$500,000	$5,000,000
2.1	-4.04	-2.06	-1.45	-0.31
2.2	-1.96	-1.09	-0.69	-0.11
2.3	1.50	0.70	0.54	0.18
2.4	-2.83	-2.39	-2.16	-1.18
2.5	-1.09	-0.92	-0.83	-0.45
2.6	2.01	1.92	2.48	2.00

influenced by the behavior of the smaller estates. The current section focuses on the observations corresponding to estates with real net values (that is, gross estate minus charitable and marital deductions) of at least $500,000.[13] These estates accounted for 78 percent of all charitable bequests in 1963. This reduces the sample to only 54 observations and makes precise estimation even more difficult. Nevertheless, the results are quite interesting and nearly all of the calculated price elasticities imply a substantial price sensitivity.

Table 6 presents the estimated parameters for the same specifications as in Table 2. The price variable is again P1. With the exception of equations 6.3 and 6.6, the price variable has a significant effect on the ratio of giving to estate size. Table 7 shows the price elasticities corresponding to these equations.[14]

IV

BEQUESTS BY MAJOR TYPES OF DONEES

In six of the nine sample years, the Internal Revenue Service published separate estimates of charitable bequests made to three major types of donees: private educational institutions, public educational institutions, and religious organizations. These disaggregated data are analyzed briefly in the current section.

Unfortunately, the gifts identified as going to these three categories of donees account for a relatively small proportion of total bequests. Table 8 presents data by estate size for 1961, the last year of the sample with disaggregated information. The residual category of "other" donees received some 50 percent of charitable bequests from small estates and more than 70 percent from estates of more than $500,000. It is not clear whether this large residual category actually reflects gifts to other types of donees, especially to private family foundations, that will later distribute these funds to particular institutions, or merely the problems of identifying particular types of donees from available records. In either case, the disaggregated data and their implications must be regarded with substantial caution.

Table 4

Effects of Price and Estate Size on Charitable Bequests: Price Measured by P2

Equation	Dependent Variable	Constant	P2	$(P2)^2$	E	E^2	$P1 \cdot \ln(E)$	R^2
4.1	G/E	0.115 (0.009)	-0.110 (0.011)		0.101×10^{-7} (0.009)			0.80
4.2	G/E	0.217 (0.078)	-0.402 (0.185)	0.199 (0.109)	0.150×10^{-7} (0.054)	-0.391×10^{-15} (0.109)		0.87
4.3	G/E	0.106 (0.065)	-0.582 (0.153)	0.179 (0.090)	0.162×10^{-7} (0.045)	-0.354×10^{-15} (0.131)	0.030 (0.004)	0.91
4.4	ln(G/E)	-1.107 (0.163)	-3.208 (0.200)		0.461×10^{-7} (0.160)			0.78
4.5	ln(G/E)	4.063 (1.58)	-16.15 (3.77)	7.980 (2.229)	-0.153×10^{-6} (0.111)	0.229×10^{-14} (0.324)		0.82
4.6	ln(G/E)	0.799 (0.905)	-21.43 (2.13)	7.404 (1.245)	-0.120×10^{-6} (0.062)	0.338×10^{-14} (0.181)	0.849 (0.068)	0.97

Price variable P2 is based on the taxable estate plus both charitable bequests and the marital deduction.
Standard errors are shown in parentheses.
All estimates refer to 135 observations in the period 1948 through 1963.

Table 5

Price Elasticities of Charitable Giving:
Price Measured by P2

Equation	Estate Size $80,000	 $120,000	 $500,000	 $5,000,000
4.1	-5.47	-2.45	-1.65	-0.33
4.2	-0.20	-0.10	-0.06	-0.01
4.3	1.46	0.77	0.59	0.20
4.4	-2.86	-2.41	-2.18	-1.19
4.5	-0.17	-0.14	-0.13	-0.07
4.6	2.64	2.48	3.07	2.40

Table 8 implies that the gifts recorded as going to religious organizations received an almost constant share of total giving and of total estates for all size estates up to $1 million. These gifts were about 0.7 percent of total estates between $60,000 and $1,000,000 and rose only to about 1 percent for estates between $1 million and $5 million. By contrast, gifts to private and public education rose rapidly as a percentage of total estates.

Because of the obvious inadequacy of the disaggregated data, only a cursory analysis has been performed. Table 9 presents the estimated price and estate size coefficients for the basic specification of equation 1 and the corresponding price elasticities.

The parameter estimates indicate that the share of the estate recorded as going to private education is quite sensitive to price, except perhaps for the largest size estates. Gifts to public educational institutions show approximately equal sensitivity while gifts to religious organizations are least sensitive.

It should again be emphasized that most of the charitable bequests were not allocated to any one of these three categories and that the analysis therefore may substantially misrepresent the effect of taxes on individual types of donees. The current results are put forward as preliminary estimates based on the only available data. A more careful classification of charitable bequests by the Internal Revenue Service would provide an opportunity to provide a much better analysis of the effect of the estate tax on different types of donees.

V

CONCLUDING REMARKS

This study has analyzed the only available time series data on charitable bequests by estates of different size. The evidence generally implies that charitable bequests are quite sensitive to the price of such bequests that is implied by the current deductibility of charitable bequests for estate tax purposes. Most of the functional specifications that yield negative price elasticities over the entire range indicate high

Table 6

Effects of Price and Estate Size on Charitable Bequests by Large Estates*

Equation	Dependent Variable	Constant	P1	$(P1)^2$	E	E^2	P1·ln(E)	R^2
6.1	G/E	0.235 (0.034)	-0.255 (0.052)		0.416×10^{-8} (0.155)			0.78
6.2	G/E	-0.371 (0.234)	1.309 (0.604)	-1.042 (0.420)	0.368×10^{-7} (0.136)	-0.813×10^{-15} (0.357)		0.81
6.3	G/E	-0.421 (0.361)	1.642 (1.914)	−1.226 (1.085)	0.389×10^{-7} (0.181)	-0.862×10^{-15} (0.448)	0.010 (0.056)	0.81
6.4	ln(G/E)	-0.594 (0.273)	-3.157 (0.417)		-0.375×10^{-8} (1.240)			0.78
6.5	ln(G/E)	-6.366 (1.72)	13.519 (4.446)	-12.510 (3.095)	0.237×10^{-6} (0.100)	-0.524×10^{-14} (0.263)		0.84
6.6	ln(G/E)	-3.482 (2.60)	-5.652 (13.79)	-1.962 (7.815)	0.112×10^{-6} (0.130)	-0.244×10^{-14} (0.323)	0.588 (0.401)	0.85

*Price variable P1 is based on the taxable estate plus charitable bequests. Observations refer to estates with real 1958 value of at least $500,000. All estimates are for 54 observations in the period 1948 through 1973.

Table 7

Price Elasticities of Charitable Giving for Large Estates

Equation	Estate Size $500,000	$1,000,000	$5,000,000
6.1	-2.72	-2.05	-0.58
6.2	-9.50	-6.42	-2.13
6.3	-1.65	-1.40	-0.70
6.4	-2.15	-1.99	-1.17
6.5	-7.82	-7.25	-4.26
6.6	-1.27	-0.92	-0.19

price elasticities, almost always greater than one and often substantially greater. These results are strengthened by separate estimates for large estates that indicate even higher price elasticities for these bequests.

The implications of such high price elasticities are clear and important. (1) The current deductibility feature of the estate tax law induces a substantial increase in charitable bequests. (2) The charitable organizations receive more in additional bequests than the Treasury foregoes in potential estate tax revenue. (3) Private intergenerational transfers of wealth to individuals are therefore reduced; because charitable gifts are increased by more than taxes are reduced, the personal heirs now receive less than they would if the current deduction were eliminated.

Nevertheless it is important in concluding this paper to emphasize that the specific estimates of the price elasticity of charitable bequests are quite sensitive to the particular specification of the equation. The equations that best explain the data for the entire sample imply positive price elasticities. Similarly, the simple constant elasticity specification also has a positive price elasticity. Even the specifications that imply negative price elasticities often have implausibly large elasticities. Finally, the data for disaggregated analysis by type of donee were quite inadequate because of the very large unallocated fraction of charitable bequests.

What interpretation should therefore be given to this study as a whole? Some readers will undoubtedly conclude from the instability of the parameter estimates and the frequency of implausible estimates that the current evidence is without value. Others however will stress that nearly all of the acceptable specifications imply substantial price elasticities and that this result supports the conclusion reached by Boskin with individual cross-section data. I prefer to leave each reader to decide for himself how the current evidence should modify his own prior beliefs.

Acknowledgements

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Table 8

Charitable Bequests to Major Types of Donees, 1960

Estate Size Class (in $000's)	All Gifts	Charitable Bequests as Percentage of Net Estate			Gifts by Donee as Percentage of Total Charitable Bequests			
		Private Education	Public Education	Religion	Private Education	Public Education	Religion	Other
$60-69	1.91	0.07	0.05	0.68	3.91	2.75	35.32	58.02
70-79	1.60	0.16	0.06	0.57	9.88	3.48	35.48	51.16
80-89	1.93	0.13	0.08	0.66	6.78	4.27	33.93	54.92
90-99	1.78	0.06	0.04	0.62	3.21	2.47	35.20	59.13
100-119	1.99	0.09	0.05	0.65	4.75	2.65	32.49	60.11
120-149	2.18	0.16	0.05	0.65	7.43	2.32	29.81	60.44
150-199	2.66	0.16	0.06	0.66	6.00	2.38	24.82	66.81
200-299	3.50	0.29	0.14	0.77	8.40	3.88	21.95	65.78
300-499	4.41	0.39	0.16	0.80	8.94	3.59	18.20	69.27
500-999	5.84	0.65	0.30	0.65	11.18	5.09	11.13	72.59
1,000-1,999	8.49	0.66	0.19	0.71	7.80	2.26	8.36	81.58
2,000-2,999	12.74	1.24	1.07	1.07	9.72	8.39	8.37	73.53
3,000-4,999	11.27	0.91	0.26	1.23	8.12	2.33	10.90	78.65
5,000-9,999	16.81	4.26	0.48	0.19	25.36	2.86	1.13	70.65
10,000+	31.12	1.46	0.84	0.11	4.70	2.69	0.36	92.24

Table 9

Effects of Price and Estate Size on Charitable Bequests, by Major Type of Donee

Equation	Donee	Sample	Constant	P1	Estate	R^2	Price Elasticities by Estate Size			
							$80,000	$120,000	$500,000	$5,000,000
9.1	Private Education	All	0.021 (0.005)	-0.021 (0.006)	0.262×10^{-8} (0.049)	.50	-7.42	-2.83	-1.78	-0.30
9.2	Public Education	All	0.011 (0.002)	-0.011 (0.002)	0.393×10^{-10} (1.723)	.31	-8.07	-2.99	-2.11	-0.57
9.3	Religious Organizations	All	0.010 (0.001)	-0.005 (0.002)	-0.190×10^{-9} (0.142)	.09	-0.80	-0.60	-0.52	-0.26
9.4	Private Education	≥$500,000	0.085 (0.028)	-0.116 (0.043)	0.616×10^{-10} (12.22)	.43	–	–	-12.82	-1.01
9.5	Public Education	≥$500,000	0.023 (0.010)	-0.026 (0.015)	-0.528×10^{-9} (0.417)	.09	–	–	-3.50	-0.90
9.6	Religious Organizations	≥$500,000	0.007 (0.007)	0.001 (0.010)	-0.811×10^{-10} (2.982)	.01	–	–	0.09	0.05

Footnotes

1. See American Association of Fund-Raising Counsel, Inc., *Giving USA* 1974.

2. Council for Financial Aid to Education, *Voluntary Support of Education 1971-1972* (New York: CFAE, 1973).

3. Because of the special marital deduction, an individual can give half of his estate to his wife and deduct that amount in computing the taxable estate. The deduction of charitable bequests lowers the price of charity relative to the price of bequests to individuals other than the decedent's spouse and bequests to the spouse in excess of the marital deduction.

4. In 1970 additional federal estate tax liabilities would have been $1.0 billion if charitable bequests were not deducted in calculating taxable estates and if total estates nevertheless remained the same. Total estate tax collections in 1970 were $3.4 billion. This calculation ignores state inheritance and death taxes.

5. Michael Boskin, "Estate Taxation and Charitable Bequests," *Journal of Public Economics* (forthcoming), 1974.

6. The studies of the effects of taxation on charitable giving by living individuals are presented in Michael Boskin and Martin Feldstein, "Effects of the Charitable Deduction on Contributions by Low Income and Middle Income Households," mimeo, 1975; Feldstein, "The Income Tax and Charitable Contributions: Part I – Aggregate and Distributional Effects," *National Tax Journal*, 28:1 (March 1975), pp. 81-99; Feldstein, "The Income Tax and Charitable Contributions: Part II – The Impact on Religious, Educational and Other Organizations," *National Tax Journal* (forthcoming), 1975; Feldstein and Charles Clotfelter, "Tax Incentives and Charitable Contributions in the United States: A Microeconometric Analysis," *Journal of Public Economics* (forthcoming), 1974; Feldstein and Amy Taylor, "The Income Tax and Charitable Contributions: Estimates and Simulations with the Treasury Tax Files," mimeo, 1975.

7. See, for example, Internal Revenue Service, Statistics of Income 1965: Fidiciary Gift and Estate Tax Returns (Washington DC: U.S. Government Printing Office, Pub. No. 406 (11-6), p. 62.

8. For estates after 1963 the Internal Revenue Service published bequests by "economic estate class" rather than "gross estate class" so that the data are no longer comparable.

9. The gross estate class lower limits are (in $1000 units): 60, 70, 80, 90, 100, 120, 150, 200, 300, 500, 1,000, 2,000, 3,000, 5,000, 10,000.

10. The individual faces two prices when making the joint decision: the price of charity and the price of gifts to a spouse. Both first dollar prices are the same since neither gift is taxed.

11. The assumption that the heirs are a spouse and minor children lowers the state inheritance tax. It would in principle be desirable to examine this in greater detail but the current results suggest that such effort may not be worthwhile.

12. The R^2 values for the two equations cannot be compared directly because the dependent variables are different.

13. More specifically, an observation is included if the mean net value in 1957-59 dollars is at least $500,000.

14. It remains impossible to obtain valid estimates of the constant elasticity logarithmic equation or its generalizations. The coefficient of the price variables are generally positive and always smaller than their standard errors. The tax schedule is apparently such that the correlation between ln P and ln E is too high to permit meaningful estimation.

A NOTE ON THE ESTIMATION OF PERSONAL GIVING

Ralph L. Nelson[†]

Introduction

At various places in the several statistical reports that accompany the Filer Commission's main report there appear estimates of the total giving by living persons. Some of the estimates have been made directly, as part of an effort to measure the aggregate amount of private giving. Others are the by-products of analyses of the economic, tax, and socio-demographic factors that influence giving behavior. The several estimates use data from a number of income tax return and household survey sources and are arrived at by a variety of analytical procedures.

A conscientious reader of these reports would be met by what at first glance might appear to be a distressingly high degree of inconsistency among the estimated totals for what should be the same thing. He might, therefore, jump to the conclusion that these researches have provided him with no clear notion of the true magnitude of personal giving. The purpose of this note is to demonstrate that this conclusion is not warranted.

This variation in the estimates of giving by living persons is the primary reason for confusion about the true *total* amount of private giving. Giving by none of the other major donor groups, corporations, foundations, bequests, and endowment earnings, are exactly measured and in some cases the basis for estimation is less solid than it is for giving by living persons. However none of the other sources accounts for more than a very small fraction of the total (less than 9 percent) whereas "living donor" giving amounts to between 70 and 80 percent of the total.

There are several reasons why the estimates cannot be expected to be in close agreement. They relate to different years, reflect progressive stages in a process of refinement, and are based on variant definitions of contributions. Table 1 presents a comparison of estimates adjusted to relate to the common year 1972. The estimates range from $15.8 to $32.2 billion, the highest being twice the size of the lowest.

Most of this rather large difference in estimates reflects the presentation of estimates in successive stages of refinement. Each of the three estimators named in Table 1 made a number of estimates. Each estimate reflected the data available for making the estimate, the estimating technique, and the assumption about giving behavior used in producing the estimate. Having made several estimates, each estimator presented what could be taken to be a "preferred" or "final" one. These are indicated by asterisks in the table. The three "preferred" estimates were $19.8, $19.9, and $23.6 billion, a range of $3.8 billion, or approximately 20 percent.

Given the potential for variation, the observed differences are neither unexpected nor unreasonable. In view of the several types of information sources and differences in estimating techniques one should not expect exact agreement in the totals. Nor, for some of the estimates, has precise estimation of the total been the primary purpose. This is particularly true for the estimates based on the findings of sample surveys of the giving patterns of families.

Reports of these surveys repeatedly stress that the findings are primarily useful for analyzing patterns and making comparisons. Blow-ups to estimated population totals are properly regarded as providing total measures which are subject to a large element of statistical sampling error.

Though susceptible to statistical error, the sample survey and econometric analyses provide valuable new insights into giving behavior which not only have

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Table 1

Several Estimates of Personal Giving in 1972 Made for the Commission on Private Philanthropy and Public Needs (in billions of dollars)

Person Making Estimates	Data Source and Method of Estimation	Estimate for 1972
Martin S. Feldstein[a]	Econometric Estimation	
	1970 Treasury Tax File = Four Price Elasticities	$22.1
	1962 Treasury Tax File = Four Price Elasticities	20.8
	1970 Treasury Tax File = Constant Price Elasticity	19.9*
Survey Research Center (Morgan-Dye-Hybels)[b]	Expansion of Sample Survey to Population Total	
	No adjustment for contributions overreporting and income underreporting	32.2
	Partial adjustments for contributions overreporting and income underreporting	26.9
	"Best" Aggregate Estimate: Downward adjustment in number of high-income families	23.6*
	"Extreme Assumption Estimate;" Adjusted for possible "pervasive underreporting of income"	20.6
Ralph L. Nelson	Total Itemized Contributions (IRS) Plus Estimated Total Nonitemized Contributions	
	Broad (As Reported on Income Tax Returns) Definition of Giving	
	No effect assigned to liberalized standard deduction	18.4
	Reflects liberalized standard deduction[c]	19.8*
	Narrow Definition of Giving[d]	
	No effect assigned to liberalized standard deduction[e]	15.8
	Reflects liberalized standard deduction	17.0

Notes to Table 1

* Signified estimate either explicity preferred or assumed to be preferred by person making the estimate. Nelson designated his "tax return" estimate as preferred in part because the other two types of estimates were based on unadjusted tax return data. See note (d) below for reasons for narrowing the definition.

a. As reported to the Commission on Private Philanthropy and Public Needs in table entitled "Simulated Changes in Total Giving and Taxes (Billions of 1970 Dollars)" and dated February 3, 1975. The 1970 estimate was extrapolated to 1972 by applying a 15 percent growth value over the two years. This growth rate was based on annual series developed by Nelson and by the American Association of Fund-Raising Counsel and presented in *Giving USA*.

b. James N. Morgan, Richard F. Dye, and Judith Hybels, *"Results from Two National Surveys of Philanthropic Activity,"* paper prepared for the Commission on Private Philanthropy and Public Needs. Appendix II, Tables A-II-6 and A-II-7. Estimates apply to the year 1973 and were extrapolated backward to 1972 by applying a 9 percent growth rate from 1972 to 1973. Basis for estimating growth rate was the same as in (a).

c. As revised in background memorandum to Wade Greene, dated June 2, 1975, in section entitled "Estimates of Total Giving by Income Class, 1972."

d. The narrow definition excludes the overreporting of gifts and the legally deductible out-of-pocket donor expenses (travel, telephone, etc.) incurred in voluntary philanthropic activity and not recorded as revenue by recipient organizations.

e. As presented in report to the Commission on Private Philanthropy and Public Needs, *Private Giving in the American Economy, 1960-1972,* January 8, 1975.

relevance in policy design but which also enable those making estimates to more precisely fill the large gaps present in the direct aggregate data on giving. The known aggregate for personal giving is the giving by persons itemizing contributions on their income tax returns, as tabulated by the Internal Revenue Service. The unknown aggregate is the giving of persons who do not itemize contributions because they either choose to take the standard deduction or do not have to file tax returns.

Both the household survey and econometric studies contain many new and much improved measures of the differences in giving behavior between itemizers and non-itemizers. Moreover, both studies provide us with detailed examinations of the reasons for the differences. These, combined with the quantitative measures provided by these studies, permit us to arrive at much more refined and unambiguous measures of the giving of non-itemizers than hitherto has been possible.

In summary, we have found that, when made comparable in time period and definition, there is a much higher degree of consistency among the several estimates than there at first appears to be. For the year 1972, as reported above, the range of differences was found to be less than 20 percent. We turn now to a detailed analysis of estimates, partly with a view toward determining just where in this range the exact amount of personal giving might be expected to fall.

Three Components of the Estimate

In the detailed analysis of the estimates, three separate but related components of the estimates will be examined. The first deals with giving by individuals and families who do not itemize their contributions on their income tax returns. Particular attention will be given to the giving of non-itemizers whose pretax income (Adjusted Gross Income, or AGI in Internal Revenue language) for 1972 was less than $30,000. Of the pretax income of all non-itemizers, 98 percent was received by individuals and families having income less than $30,000. A correspondingly high percentage of non-itemized contributions, therefore, came from incomes of less than $30,000. Focus on these income groups, therefore, will tell substantially the whole story of the non-itemizers.

The second component to be examined is the giving of families whose 1972 pretax income (AGI) was greater than $30,000. As will be shown below, the estimates made in the Survey Research Center study typically assign a very high proportion of total giving to the upper-income groups. The size of the estimate for these groups is found to depend on two things. The first relates to the validity of the data on contributions, that is, whether one should rely on the amounts reported by the respondents to the survey questionnaire or on the amounts reported as these respondents' income tax deductions for contributions. The second relates to the estimated total income of upper-income groups and in particular to the correct number of families in these groups.

The extrapolation of the survey findings for these higher income groups has led to questionably high estimates of their contributions. Expansion of the survey results for the year 1973 places giving by these higher income families at an estimated $7.37 billion.[1] Yet for 1972, the year before, the Internal Revenue Service reported that families with $30,000 or more in pretax income itemized a total of $3.76 billion in contributions. Given the very low proportion of the total income in these income classes whose recipients did not claim a contributions deduction (about 5 percent), the total contributions from all high-income givers could not have exceeded $4 billion by very much. Literally interpreted, this would mean an improbable 84 percent growth in upper-income giving between 1972 and 1973.

The third component of the estimate, separate from but related to the first two, concerns the adjustments that are made to allow for the incorrect reporting of contributions and for ambiguities in definition. The two problems are partly related, as incorrect reporting in part is a result of differing perceptions of what constitutes a philanthropic contribution. In addition to this, incorrect reporting also involves either the underreporting or overreporting of contributions.

Illustrative of the general problem is the correction that the Survey Research Center felt compelled to make in successive revisions of its aggregate estimates. Giving data reported by the respondents in the survey yielded an estimate of total giving $3 billion higher than that made using the itemized contributions on the tax returns of the same respondents. The same discrepancy existed whether based on unadjusted reported incomes or on reported incomes adjusted for underreporting.[2]

The tax definition of giving is a relatively specific one, and in the above comparison of the Feldstein, Morgan, and Nelson estimates, served adequately as the common measure for comparisons. Yet even the tax return data may be incorrect to the degree that they reflect underreporting of contributions by some persons and overreporting by others. The former results from forgetfulness and caution, the latter from either unconscious or conscious exaggeration. Though largely indirect and impressionistic, the scattered evidence of the matter suggests that on balance there probably has been overreporting.

A specific adjustment of the estimates for overreporting will not change their relative size, as in the comparisons presented above all estimates are based primarily or entirely on the amounts reported on tax returns. However, a clearer idea of the degree of overreporting will lead to an improved measure of the actual amounts given and produce donor estimates more concordant with those based on data for recipient organizations.

Giving by Non-Itemizers

As mentioned above, this analysis relates to the non-itemized giving of families whose 1972 AGI was less than $30,000, and which accounts for all but a very small proportion of total non-itemized giving. All three investigators, Feldstein, Morgan, and Nelson, found that for families of comparable income level, the non-itemizers gave significantly less than did the itemizers, and this difference is reflected in each set of estimates. However, the techniques for imputing the giving of non-itemizers were unique in each case and produced wide differences in the estimates of total non-itemized giving. Each involved comparison of the behavior of itemizers with that of non-itemizers, and the methods and results varied with the approach used.

Feldstein, individually and in collaboration with others, constructed a number of econometric behavioral models which relate giving to factors such as tax rate, income, age, and marital status. He estimated the equations using Treasury data for a cross-section of tax returns. The equations, thus derived, were used to predict the giving of non-itemizers. Drawing upon survey data on giving by both itemizers and non-itemizers, he found that the principal operational effect of non-itemization was a price effect. Non-itemizers give less because they pay an after-tax "price" of 100 percent of the amount of their gifts. Itemizers, on the other hand, pay something less than 100 percent by virtue of the tax savings resulting from the deductibility of their gifts. He found some minor effect for itemization as such, apart from the price effect but regarded it as not statistically significant.[3]

Feldstein's findings of the primacy of the importance of "price," as versus pure itemization, are consistent with the findings of an earlier household survey study made by Roistacher and Morgan. There it was noted that "The effects of itemization seem to be mostly the effects of income [working through the right to itemize and the marginal tax rate and the ability to give] . . ."[4] In that study itemization is found to be incidental to homeownership, and homeownership to be a function of income and the interrelated variables of age, marital status, and family size. These, however, are also factors that directly (and strongly) influence giving behavior. Feldstein's multiple regression equations also assign great importance to income and age and thus broadly corroborate these findings.

Feldstein's estimate of the giving of non-itemizers turns primarily on the measures of price elasticity produced by the econometric analysis. It turns most particularly on the elasticity measures for the below $30,000 income classes in those variants of his analysis in which separate elasticities are estimated for the several (four) income classes he specifies. He found that, in this income range, price elasticities were quite high (-2 to -3). As the price for non-itemizers (100 percent) is substantially higher than that for itemizers (72 to 85 percent), he estimates that, all else the same, giving for non-itemizers is substantially lower than that for itemizers.

The effect on the estimate of non-itemized giving is illustrated in the following tabulation which compares two of Feldstein's estimates for the year 1970.[5]

Estimated Price Elasticity		Estimated Total Giving (in billions)	
$4,000 to $20,000 Income	$20,000 to $50,000 Income	All Families	Non-Itemizers
-3.67	-0.97	18.1	5.2
-0.35	-0.85	19.2	6.3

It is seen that the higher measure of price elasticity produced a lower estimate of total non-itemized contributions. The two estimates were based on different data sets, the first on the 1962 Treasury Tax File and the second on the 1970 Treasury Tax File. In each case it was specified that separate elasticities be estimated for each of four income classes, and divergent measures, particularly for the $4,000 to $20,000 income classes were found. Feldstein has more confidence in the higher price elasticity estimate for low-income givers yielded by the 1962 Treasury Tax File than for the lower elasticity estimate yielded by the 1970 File, stating that "these [1970] data are just not sufficiently rich to provide accurate information on both price and income elasticities."[6]

In most of his simulations of the effect of tax changes on giving and in his preferred estimate of total giving, Feldstein returns to an earlier, less detailed model.[7] This is one that assumes the same price elasticity for all income classes. While believing that the evidence of high price elasticity for low-income givers is "reasonably consistent and clear," he encounters difficulty in sorting out price and income effects, particularly in the low-income subgroups of his various data samples. He finds that "The disaggregated results are generally much less accurate than the overall price elasticity. The low-income itemizers are an unrepresentable sample of low-income households."[8]

There is another source of uncertainty about the implications of Feldstein's econometric findings for the response of low-income givers to proposed changes in the tax treatment and thus the "price" of their giving. This uncertainty arises because the analyses are based on cross-sectional data which, in essence, are a "stop-action" snapshot of families in a system of changing giving propensities, wholesale shifts in income classes and tax brackets, and unfinished adjustments to new equilibrium relationships. This is one element in the more general problem that arises in the use of cross-sectional data to predict behavioral changes:

> The changes [in giving resulting from changes in tax policies], computed from cross-section data pertaining to different individuals at a point in time, may approximate how individuals will respond to changes in tax policies

through time. However, it can be that responses to changed tax policies through time can be different from those predicted by a cross-section analysis.[9]

For the purpose of estimating the total giving in the period to which the cross-sectional data apply, the econometric equations are much less subject to qualification. For this purpose, the equations can be regarded as a system of structural relationships whose parameters provide the means for estimating total giving, particularly that of the non-itemizers for whose unreported giving the equations provide a multi-factor basis for imputation. Separation of the effect of specific factors is not as critical to the estimate.

In presenting an estimate of the existing level of total giving as a reference for measuring the effects of tax changes, Feldstein uses the estimate based on the assumption of the same price elasticity for all income classes. The procedure is described as follows:

> In 1970 total giving on itemized returns was $13.0 billion. The remaining $4.3 billion is our estimate of the total giving by taxpayers who filed non-itemized returns (i.e. who used the standard deduction). This amount is estimated for each non-itemized return [using the multiple estimating equation] and aggregated with the appropriate weights.[20]

The estimate of $17.3 billion for 1970 translates into one of $19.9 billion for 1972, as presented above in Table 1. This assumes a 15 percent growth in giving over the two-year period.

The findings from household surveys reported by the Survey Research Center, like those of Feldstein, suggest that for families of comparable incomes, non-itemizers made significantly lower contributions than did itemizers. This is summarized in Table 2 for families in the survey with 1973 incomes of less than $30,000, the income range from which the bulk of non-itemized contributions originated. The differences described in Table 2 are of the same order of magnitude as those implied by Feldstein's elasticities applied to the "price" (complement of tax rate) differences between itemizers and non-itemizers.

Table 2

Average Giving of Itemizers and Non-Itemizers
to Low- and Middle-Income Classes
1973

Income Class	Average Giving Per Family		Ratio: Non-Itemizers to Itemizers
	Itemizers	Non-Itemizers	
Less than $ 4,000	$ 119	$ 69	0.58
$ 4,000 - $ 7,999	215	89	0.41
$ 8,000 - $ 9,999	314	117	0.37
$10,000 - $14,999	407	201	0.49
$15,000 - $19,999	600	329	0.55
$20,000 - $29,999	800	354	0.44

Source: Morgan, Dye, and Hybels, "Results From Two National Surveys of Philanthropic Activity," Table 24.

This examination of the two types of study illustrates the value of multiple research approaches. In both the econometric and household survey studies the primary objective was the description of behavioral patterns and the analysis of the family characteristics that influence giving. Estimation of total giving was a carefully qualified secondary product of the analysis. In the process, however, both types of study have given us a much clearer picture of the behavior of non-itemizers. In this way they have laid the groundwork for much improved estimates of total giving. The implication to be drawn from these studies is that non-itemized giving accounts for a much smaller part of total personal giving than many may have believed it to be.

Whereas the Feldstein and Survey Research Center estimates are based on extrapolations of micro-economic data, that made by Nelson is based on data on aggregate giving and income. Nelson begins with aggregate itemized contributions as reported by the IRS. To this he adds an estimate of the total contributions of non-itemizers and non-filers. This estimate is arrived at by applying a specified giving percentage to the aggregate Adjusted Gross Income of everyone other than those itemizing contributions.

The percentage chosen to apply to the income of non-itemizers and non-filers is critical to the estimate. Nelson adopted the percentage estimated by C. Harry Kahn as presented in his study, *Personal Deductions In The Federal Income Tax.* Kahn based his estimate on an analysis of changes in contributions percentages across years when changes were made in the standard deduction. Kahn's latest estimate (his series ended in 1954) reflected the 1948 liberalization of the standard deduction and resulted in an upward revision in the earlier percentages applied to non-itemizers and non-filers.

No broad changes were made in the standard deduction from 1954, the final year in Kahn's series, through 1970. Accordingly, Nelson applied an unchanging percentage rate to his estimates of the aggregate AGI of everyone other than itemizers over the 1960 to 1970 period, and in his original (January 1975) report, through 1972. The assumption of an unchanging percentage giving rate for non-itemizers is open to question. However, a number of offsetting trends were observed, which led to the belief that the constant percentage assumption would yield tolerably accurate estimates of non-itemized giving.[11]

For the reference year 1972, however, the assumption of unchanging giving percentage became much less tenable. Itemized and non-itemized giving in that year reflected the broad liberalization of the standard deduction contained in the Tax Reform Act of 1969. After more than two decades of unbroken increase, the number of returns containing itemized contributions fell sharply in 1972. This development was explicitly included in a recent upward revision of the estimate for 1972,[12] and drew upon information provided by the Feldstein and Survey Research Center studies. Both studies suggested that the giving rate for the "new" non-itemizers (that is, itemizers in 1970, non-itemizers in 1972) was higher than that for the "old" non-itemizers (that is, non-itemizers in 1970 and 1972).

The effect of this revision was to increase the 1972 estimate of total personal giving from $18.4 billion to $19.8 billion, or by 7.6 percent. The original giving percentage applied to total "non-itemized" AGI was 1.44 percent; the revised rate was 1.84 percent. Both estimates use the "contributions deduction on income tax return" definition of personal giving and so may be directly comparable to the estimates contained in the other two kinds of studies.

Giving by Upper-Income Families

The second component of the estimate to be examined is the giving of upper-income families, those having 1972 pre-tax incomes of $30,000 or more. One of the more generous estimates (Survey Research Center "Best Aggregate Estimate") credits upper-income givers with 29 percent of the total 1973 personal giving, or

$7.4 billion of $25.7 billion. One of the less generous estimates (Feldstein, Separate Elasticities for four income classes, 1962 IRS data) credits upper-income givers with about 15 percent of total 1970 personal giving, or approximately $2.8 billion of $18.1 billion.

Illustrative of the problem encountered in estimating the contributions of upper-income givers is the effort by the Survey Research Center to expand its sample survey findings to an estimate for the total population. In its first attempt, it expanded its survey results with no adjustments for either the overreporting of contributions or the underreporting of income. It estimated a total of $13.8 billion of giving by families reporting income of $30,000 or more, 39 percent of total estimated giving of $35.1 billion for all income groups.

It found that the income data in one of the two samples used in the survey was not reliable for reported incomes under $50,000 because of "pervasive underreporting of income." This produced a misleadingly high percentage of giving to income. When this was expanded by the proportion of such apparent income recipients in the population, the result was a major overestimation of total giving. With the removal of the unreliable (Census) sample of reported incomes under $50,000 from the estimating process, total estimated giving declined from $35.1 to $32.4 billion, of which $12.6 billion, or 39 percent, came from incomes of $30,000 or more.

The next adjustment took account of the discrepancy between a family's giving as reported to the survey taker and that reported on its income tax return ("amount deducted"). This adjustment applied to those respondents for whom both amounts were available and where the amount deducted on their income tax returns was different from, and usually lower than, the amount reported to the survey taker. The adjustment thus takes partial account of this particular kind of overstatement though it retains any overstatement present in the income tax deduction. The adjustment reduces total estimated giving from $32.4 to $29.3 billion in the estimates with the aforementioned correction for income overreporting.[13] Even with the adjustments, however, incomes over $30,000 account for $11 billion or 37 percent of the total.[14]

One final adjustment was made because the earlier procedures "in retrospect overestimated the numbers [of households] in the income groups over $50,000."[15] If actual numbers of tax returns over $50,000 are used, instead of the original blown-up numbers, total giving is estimated at $25.7 billion, down from $29.3 billion. Giving by families having $30,000 or more in 1973 income totals $7.4 billion, down from $11 billion, and accounts for 29 percent of the total, down from 37 percent.

Although the estimated giving of families having income of $30,000 or more was reduced from $13.8 to $7.4 billion, it is probably still too high. It will be recalled that this $7.4 billion of 1973 giving was roughly twice the $3.76 billion in 1972 giving reported by the IRS for families with incomes of $30,000 or more. After allowing for a 9 percent growth from 1972 to 1973, the discrepancy still exceeds $3 billion.

In summary, the Survey Research Center's "Best Final Estimate" of $25.7 billion for 1973 probably still reflects some underreporting of income and overreporting of contributions, both biases leading to an overestimation of total giving. Having been reduced by $9.4 billion from the first estimate, probably an additional $2 billion to $3 billion of "fat" remains to be rendered were it possible to carry to completion the above-described refinements. If so, the 1972 "perfect" estimate, allowing for 9 percent growth from 1972 to 1973, would then be in the range of $20.8 to $21.7 billion. This would be reasonably comparable to Feldstein's preferred estimate of $19.9 billion and to Nelson's revised estimate of $19.8 billion.

Overreporting of Contributions

The third component to be examined is the matter of overreporting. In the reconciliation presented above, all estimates have been either based on or related to the statistics of personal giving as developed by the IRS in its tabulations of individual income tax returns. Lacking direct evidence on the focus and degree of overreporting, no attempt was made by either Feldstein or the Survey Research Center to adjust their contributions data for this practice. Nelson, in his original report, presented estimates that made explicit adjustment for a combination of overreporting and legally deductible out-of-pocket donor expenses (travel to meetings, phone calls, and so forth) not recorded as contributions by donees. Up to this point in the present reconciliation, this adjustment was not made, the objective being to make the Nelson estimates comparable in definition to the other two estimates.

The Nelson "correction" involved a downward adjustment of tax return giving data of 14 percent. This was applied uniformly to all income classes and all years.[16] The adjustment was based primarily upon a direct comparison of the "same" gifts as reported on donor tax returns and by recipient organizations made by Dr. Kenneth G. Lutterman for the year 1959.[1[illegible]] Which part of the 14 percent represents legally deductible expenses incurred in voluntary philanthropic activity and which part represents overreporting is problematical. Efforts to try to measure it more precisely would probably flounder for lack of hard evidence.

In view of these problems no attempt has been made to develop a precise estimate of the amount of overreporting present in the tax return data on giving. Accordingly, the discussion presented in this section must necessarily be tentative, with possibly relevant indirect evidence presented to suggest something about patterns and incentives.

Though indirect and conditional, the evidence is not inconsistent with the hypothesis that overreporting may well be sufficiently common and large enough as to have a measurable effect on estimates of total giving. For purposes of illustration, this analysis will concentrate on possible overreporting by taxpayers in the $10,000 to $30,000 income range. This is the income range from which more than half of itemized contributions come, as well as roughly one third of non-itemized contributions. If significant, overreporting in this income range could have a material effect on estimated total giving, first through the direct tax return data on itemized contributions and, then, by extrapolation of these data to the estimate for non-itemizers.

The incentive to overreport contributions may be reasonably strong for taxpayers in these income classes. Facing marginal federal tax rates of from 19 to 36 percent, as well as state income taxes in many cases, these are the income groups in which, to use the words of the Survey Research Center report, "the ability to itemize is borderline, changing, and probably influential."[18]

While it would be hard to document, the use of professionals in the preparation of income tax returns may lead to some overreporting of contributions. Indeed, one of the possible benefits to the taxpayer from such help is advice on the amounts of deductions not likely to be questioned by the IRS. The Survey Research Center found that most (almost three in five) of the households in these income classes used paid professsionals in the preparation of their income tax returns, with accountants and tax services accounting for most of the income tax assistances. (See Table 3.)

The risks of overreporting to taxpayers in these income classes may not be great. The probability of an IRS audit is likely to be small, and the additional tax and penalties, if part of the contributions deduction were disallowed, would not be severe. The revenue gain to the IRS would be modest, possibly not covering the

Table 3

Income Tax Help Received, By Income
(percent of income class)

				Type of Help				
		Got Help						
Income	No Help	Paid	Free	Accountant	Lawyer	Tax Services	IRS	Friends Relative, Other
$0–999	53%	35%	12%	15%	4%	19%	2%	9%
$10,000–19,999	36	57	7	25	5	28	1	5
$20,000–29,999	38	58	4	35	3	20	0	3
$30,000–49,999	34	63	3	45	6	13	0	1
$50,000–99,999	27	69	4	60	7	5	0	1
$100,000–199,999	7	93	0	69	18	0	0	0
$200,000–499,999	0	100	0	100	0	0	0	0
$500,000–or more	0	100	0	100	0	0	0	0
All	44	46	10	21	5	22	1	7

Source: Morgan, Dye, and Hybels, "Results from Two National Surveys of Philanthropic Activity," Table 16.

cost of the audit, given the typical size of itemized contributions in these income classes. In 1970, for example, itemized contributions averaged $315 in the $10,000-to-$15,000 AGI class, $415 in the $15,000-to-$20,000 AGI class, $557 in the $20,000-to-$25,000 class, $699 in the $25,000-to-$30,000 class. Disallowance of, say, 10 to 20 percent of these contributions at marginal tax rates of 19 to 36 percent would yield only modest additional revenues to the IRS.

A tax incentive to *itemize*, as distinct from the incentive to *give*, may be one interpretation of the responses of households to the questionnaire survey conducted by the Survey Research Center. Of the 253 people in the survey who had started to itemize in the past 5 years, only 21 (8 percent) said that it had had any effect on their giving. Of the 137 who had stopped itemizing, only 10 (7 percent) said that this had had any effect on giving. Yet as shown above in Table 2, there were large differences in reported giving between the itemizers and non-itemizers in the survey. How much of the differences reflects a underestimation of their behavioral response to tax incentives and how much an exaggeration of their contributions it is not possible to know. However, the findings, taken together, are not inconsistent with the assumption of at least some exaggeration.

The efforts of the Survey Research Center to adjust for overreporting of contributions in its refinement of the estimate of overall personal giving have been mentioned above. There the problem was one of memory bias, that is, the incorrect recall of amounts given to various charities. The bias is apparently common when detailed questioning of respondents is involved, and it is in the direction of net overreporting.[19] The procedure used by the Survey Research Center to correct for this bias was to substitute the respondents' income tax charitable deduction, if available, for the total gifts reported to the survey taker, the latter being "often somewhat larger."

On the assumption that some of the same kind of memory bias may be present in the contributions figures reported on income tax returns, the Survey Research Center's correction is reexamined in more detail here. In the aggregate, the correction reduced the estimate of total giving by about 9 percent (see above). The correction for the $10,000-to-$30,000 income classes is summarized in Table 4. Here it is seen that the bias was much more pronounced in the $20,000-to-$30,000 income class than in the $10,000-to-$20,000 class, however this in part may be statistical, a reflection of sampling variation. Overall, the correction averages out to about 9 to 11 percent, about the same as the correction made for the aggregate total.

Table 4

Survey Research Center's Adjustments for Overreporting of Giving,
Two Income Distributions, $10,000-to-$30,000 Income Classes
1973[a]

	Original Income Distribution[b]			Revised Income Distribution[c]		
	Average Gift:			Average Gift:		
Income Class	Total Reported	Adjusted for Overreporting	Percent Change	Total Reported	Adjusted for Overreporting	Percent Change
$10,000–$19,999	422	408	- 3.3	378	365	- 3.4
$20,000–$29,999	849	720	-15.2	830	672	-19.0

a. Includes both itemizers and non-itemizers.

b. Morgan, Dye, Hybels, "Results From Two National Surveys," Tables A-II-1 and A-II-6.

c. Ibid., Tables A-II-4 and A-II-5.

Though indirect and suggestive, the available evidence points to the probable existence of moderate overreporting of contributions on tax returns. The amount of overreporting is not capable of any degree of precise measurement, nor is the balance between unconscious and conscious exaggeration. However, the degree of overreporting is probably large enough to warrant an adjustment in the estimates of total giving based on tax return data, though any specific adjustment must presently be based on a subjective evaluation. The author feels that a 5 to 7 percent adjustment would not be inappropriate; if anything it might err on the side of understatement.

Conclusion

A 5 to 7 percent adjustment for overreporting has been applied to the "preferred" estimates made by Feldstein, Morgan, and Nelson, as these were reconciled, revised, and presented on pages 1508 above. Thus corrected, the estimates probably represent the most defensible available range of estimates of the number of "true" philanthropic dollars coming from living donors in 1972. The range so computed is from $18.4 billion to $20.6 billion.

This examination of the several studies of personal giving has demonstrated several things. First, it has shown that much of the apparent disagreement among estimates of total personal giving results from differences in time period, definition, and stage of refinement. Second, it has illustrated how the variety of comparative descriptions and analyses could be used to provide better measures of aggregate giving. This has been particularly true in using comparisons of itemizers and non-itemizers to estimate non-itemized giving, the major "unknown quantity" in the aggregate. Third, analysis of progressive refinements in the estimate provided a more precise notion of the amount of giving by upper-income families, a finding of particular importance to certain groups of donees. Fourth, the rich detail of the household survey study yielded a number of patterns suggestive of the probable degree of net underreporting in the contributions data. This provided the basis for better informed, though still subjective, correction of the estimate.

Footnotes

1. James N. Morgan, Richard F. Dye, and Judith Hybels, "Results from Two National Surveys of Philanthropic Activity," paper prepared for the Commission on Private Philanthropy and Public Needs, "One Final Adjustment: Our 'Best' Aggregate Estimate," Table A-II-7.

2. Ibid., Appendix II, Table A-II-4, A-II-5, and A-II-6.

3. For the most recent elaboration of this analysis see Michael J. Boskin and Martin S. Feldstein, "Effects of the Charitable Deduction on Contributions from Low-Income and Middle-Income Households: Evidence from the National Survey of Philanthropy," paper prepared for the Commission on Private Philanthropy and Public Needs, pp. 1446-48. Though based on household survey data, the findings are in general accord with those based on tax return data on which his estimates of aggregate giving are based.

4. Elizabeth A. Roistacher and James N. Morgan, "Charitable Giving, Property Taxes and Itemization on Income Tax Returns" (Survey Research Center, 1974), p. 47.

5. Price elasticities: Martin S. Feldstein and Amy Taylor, "The Income Tax and Charitable Contributions: Estimates and Simulations with the Treasury Tax Files," paper prepared for the Commission on Private Philanthropy and Public Needs, Table 3. Aggregate estimates: Feldstein, see note (a) Table 1.

6. Ibid., p. 1430.

7. Ibid., p. 1431.

8. Ibid., p. 1430.

9. Arnold Zellner, "Evaluation of Econometric Research on the Income Tax and Charitable Giving," paper prepared for the Commission on Private Philanthropy and Public Needs, p. 1520.

10. Feldstein and Taylor, op. cit., p. 1432.

11. Such accuracy was judged acceptable in the context of a research effort involving the estimation of a variety of donor and recipient components under the constraint of time and budget limitations. Any error in the estimate would relate to a 10 to 15 percent component of total giving from all sources.

12. Memorandum from Ralph L. Nelson to Wade Greene, June 2, 1975.

13. The adjustment, with no correction for income underreporting, is approximately the same, reducing estimated total giving from $35.1 billion to $32.1 billion.

14. This adjustment for overreporting is partial in yet another sense: "Except for using 'amount deducted' where different from 'total giving,' we have not made any adjustments for response bias in the aggregate estimates. Any cautious user of our results should be aware of this problem (i.e., that of the 25 percent nonrespondents, those with less giving to report may have been more reluctant to be interviewed.)" Morgan, et. al., op. cit., p. 242.

15. Morgan, et. al., op. cit., p. 243.

16. One reason why Nelson made this adjustment was to provide for greater conceptual agreement (in an accounting sense) in the estimates based on varied donor and recipient data sources.

17. Kenneth G. Lutterman, *Giving to Churches: A Sociological Study of the Contributions to Eight Roman Catholic and Lutheran Churches* (unpublished Ph.D. dissertation, University of Wisconsin, 1962), Table 4-1, p. 4-15.

18. Morgan, et. al., op. cit., p. 239.

19. Ibid., pp. 241-42.

EVALUATION OF ECONOMETRIC RESEARCH ON THE INCOME TAX AND CHARITABLE GIVING

Arnold Zellner†

This paper was written in response to a request from the Commission on Private Philanthropy and Public Needs for an evaluation of the econometric study measuring price and income elasticities of charitable giving by individuals prepared for the Commission by Professor Martin S. Feldstein and his associates.

Does the Feldstein Study Represent the Current State of Econometric Skills?

The analyses performed by Professor Feldstein and his associates employ standard econometric and statistical techniques in a knowledgeable fashion. The methods employed appear to be thoroughly understood by the investigators and the results of their applications are clearly and accurately presented. The methods employed include statistical estimation and testing procedures. Their statistical estimation procedure, classical least squares, is a standard and widely used method in econometrics and statistics that is regarded as yielding very satisfactory results when applied correctly. Similarly, the procedures employed to construct confidence intervals for and test hypotheses about the values of income and price elasticities are standard econometric and statistical procedures that are generally regarded to yield satisfactory results when applied correctly. Thus, the major statistical methods employed by Professor Feldstein and his associates are widely used and accepted methods.

As regards the economic principles underlying the analyses of charitable giving, most econometricians and others would agree with Professor Feldstein and his associates that an individual's income and the price of charitable giving are important factors that affect the amount that an individual gives to charity. Most would also agree that certain other characteristics of individuals might be related to the amount that is given to charity, for example an individual's age, wealth, and his marital status. Variables such as income, price, wealth, age, and marital status have been employed in many previous studies similar to the one under consideration. Thus with regard to the problem of choosing appropriate variables to include in their analyses, Professor Feldstein and his associates have utilized an approach that has been used in many other econometric studies. Further work to show explicitly that standard economic theory also justifies the use of just the variables employed in the analyses would be worthwhile and is usually regarded to be a standard operational procedure in good econometric work. It is probably the case that standard economic theory can justify the use of the variables employed in Professor Feldstein's empirical analyses and this should be made explicit in the final report.

Professor Feldstein and his associates have used their empirical relationship for charitable giving to predict what might happen to the amount of charitable giving if the tax treatment of charitable contributions were changed. In the research papers the results of such calculations were reported. Since these calculations are of great importance, it is critical that they be performed and reported in the best possible manner. Two points are particularly relevant here. First, any calculated predictions should be accompanied by measures showing how reliable the predictions are. Standard methods are available that provide such measures, technically called

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"prediction intervals." Prediction intervals indicate quantitatively the margin of uncertainty associated with a prediction, and their calculation would provide readers with extremely valuable information about the precision of the predictions. These prediction precision measures should be calculated for changes in the *total giving* of various groups of givers. Second, it appears that Professor Feldstein and his associates have used their empirical relationships to predict the *logarithm of charitable giving* for each individual and from this prediction have obtained the prediction of actual giving. It would be desirable to take account of the logarithmic nature of their model and use methods in the literature to calculate better predictions for charitable giving. Technically, this is the problem of getting good predictions for a variable, here charitable giving, that is related to other variables in a "log-normal" regression. Thus, to be consistent with the current state of econometric practice, it is necessary for Professor Feldstein and his associates to take account of the logarithmic nature of his relationship for charitable contributions in calculating predictions and to calculate measures of precision to accompany his calculated predictions.

Are Appropriate Econometric Techniques Employed?

The main objectives of Professor Feldstein's econometric analyses appear to be determination of the form of the mathematical relationship or equation relating charitable giving to other variables such as income, price of charitable giving, and so forth, and determination of the sensitivity of charitable giving to changes in income and in the price of charitable giving. Since the price of charitable giving is approximately equal to 1−m, where m is an individual's marginal tax, determining the *form* of the relationship connecting charitable giving, the price of charitable giving, and other variables will provide an important link between tax policy with respect to charitable contributions that are tax deductible and the amount of such charitable contributions that an individual makes.

In efforts to find an appropriate form for the aforementioned mathematical relationship or equation, hereafter referred to as the Equation for Charitable Giving (ECG), Professor Feldstein and his associates follow usual econometric practice in formulating a tentative form for the ECG. They then proceed to use the data on charitable giving and other variables to try to determine whether or not the tentative form for the ECG is supported by the information in the data. In checking whether the postulated form of the ECG is supported by the evidence in the data, they pursued the desirable practice of using not just one sample of data but several samples of data. In addition, they checked the postulated form for the ECG using changes in charitable giving and other variables from 1962 to 1970. Further, in response to suggestions made by Dr. Joseph Pechman, they investigated the possibility that the ECG might be different for low, intermediate, and high income groups of individuals and indeed they did find such differences. Last, they devoted some attention to a form of the ECG suggested by Professor John Brittain that allows for different responses to a given proportionate change in the price of charitable giving at different income levels. Also, they experimented with different concepts of income and other formulations of the ECG that permitted different price responses for individuals at different income or wealth levels.

The analyses described in the previous paragraph entailed a considerable amount of work that has yielded interesting approximations to the form of the ECG that exhibit sensitivity of charitable giving to changes in income and the price of charitable giving. With respect to the econometric and statistical techniques employed in these analyses, Professor Feldstein and his associates have employed statistical testing procedures to determine an appropriate form for the ECG. With respect to these procedures, the following points are relevant:

1. It is usual practice to analyze the deviations of individuals' actual charitable contributions from those predicted by a tentatively entertained ECG. These deviations or "residuals" will tend to be large and exhibit systematic patterns if the ECG has been incorrectly formulated. If study of the deviations or residuals reveals no such patterns, this finding should be reported. On the other hand, existence of systematic patterns may indicate that the ECG has been incorrectly formulated. Further, the residuals should be analyzed to determine whether their dispersion is approximately the same for different income classes since the validity of many of the tests applied in the research reports depends on their being approximately the same. In summary, additional work to provide this and other results of "residual analysis" to check the adequacy of the form of the ECG and the assumptions underlying testing procedures would be very desirable and would be regarded as good econometric and statistical practice.

2. The simulated "Distributional Effects of Eliminating the Charitable Deduction, 1970," reported in Table 5 of the paper, "The Income Tax and Charitable Contributions: Estimates and Simulations with the Treasury Tax Files," by Martin Feldstein and Amy Taylor, are based on their equation (2.4). This equation incorporates the assumption that the price elasticity of charitable giving is the same at all income levels (equal to -1.285). Since the evidence supporting this assumption is very weak, additional calculations are needed to appraise the sensitivity of the results to the indicated possible variation of the price elasticity at different income levels. Also, in all of these calculations, the figures in column (4), G_i', should be accompanied by a measure of precision (a prediction interval). Further, the numbers in columns (2) and (3) and (2) and (4) should be multiplied together to yield totals and the predicted totals should be accompanied by measures of precision. Similarly, the figures in column (5) that are predictions should be accompanied by a measure of precision.

3. The suggested elaboration of the form of the ECG proposed by Professor John Brittain is a rather standard form that should be investigated further. It and variants of it appear to offer more hope of getting a satisfactory form for the ECG than do the "restricted" variants investigated by Professor Feldstein and his associates.

4. In the paper, "Tax Incentives and Charitable Contributions in the United States: A Microeconometric Analysis," by Martin Feldstein and Charles Clotfelter, the results of additional simulations, all based on the assumptions that the income elasticity is 0.87 at all levels of income and that the price elasticity is -1.15 at all levels of income, are presented. The assumptions that the elasticities do not vary with income have not been thoroughly investigated and thus the simulation results reported in Tables 4 and 5 should be treated cautiously. An example of the procedure for testing that the price elasticity does not vary with income is given in connection with equation (11). In equation (11), the price elasticities at different income levels are not very precisely determined. For example at the lowest income level, the estimate is -2.07 with a standard error of 0.80. The number 0.80 indicates that the measured price elasticity of -2.07 is not very precise. In fact, the true price elasticity is with probability .95 somewhere between about -.5 to -3.7, given that the equation is properly formulated. Similarly, the other price elasticities in this equation have not been determined very precisely. Indeed the main conclusion here should be that the elasticities are not very precisely determined. It is not clear why the authors concentrate attention on testing that the price elasticities are the same.[1] They should explain why they emphasize this hypothesis in their work. Further, the assumption that the income elasticity is the same for all income levels that is built into equation (11) should be examined more closely. Its invalidity could affect the determination of the price elasticities.[2] In summary, it is good practice to explain why attention is focused on a particular hypothesis, here equality of price elasticities at different income levels, and to consider other alternative hypotheses that are of interest. Then it would be desirable to explain how powerful the testing procedure is in discriminating between or among relevant alternative hypotheses.

5. More attention should be given to the possibility that similar results can be obtained with different data sets because the effects of errors in formulating the ECG are approximately the same in different data sets. Residual analysis, suggested above, would be relevant for checking this point.

Have the Data Bases Been Used Appropriately?

As far as I can determine, Professor Feldstein and his associates have been careful and thoughtful in their use of the data bases that they employ. They have provided useful discussion of measurement problems and have corrected another researcher's earlier work in which variables were measured incorrectly. They have paid particular attention to the problem of zero reporting of charitable contributions and the extent to which itemizers differ from non-itemizers in their charitable contributions. In addition, they have constructed interesting and useful alternative measures of income to test the sensitivity of their results to use of alternative income concepts. Finally, their use of not just one but several data bases in an effort to show that their results hold generally is extremely important and very good econometric practice.

Are the Limitations of Econometrics Generally and the Specific Methodology Employed Discussed Adequately?

Professor Feldstein and his associates provide very little discussion of these limitations, probably because they have assumed that sophisticated readers would be familiar with the general limitations of econometrics generally and the specific methodology that they employed. In my opinion, it would be desirable to provide a short general discussion of such limitations in the report. Some of the issues that might be discussed include (1) the differences between use of data generated by controlled experiments and the non-experimental data that were employed in the analyses to determine the form of the ECG; (2) the adequacy of cross-section data, that is data relating to *different* individuals at a point in time, for determining how any *one* individual would respond in his charitable giving to changes in income and the price of charitable giving at different points in time; and (3) possible "systems responses" to changes in tax policies affecting charitable giving. Regarding the last point, consideration should be given to possible adjustments of public and private charities to changes in tax policy.

As stated in the previous paragraph, it is my impression that Professor Feldstein and his associates have an awareness and good understanding of the possible limitations of their approach and of econometrics generally and thus it should not be difficult for them to provide the necessary qualifications.

Are the Conclusions Reached Justified?

One of the major conclusions of Professor Feldstein's analyses is that the price of charitable giving and income are important determinants of the amount of an individual's reported charitable contributions. He and his associates have presented extensive calculations supporting this conclusion and in this regard they have made a very significant contribution.

In his paper with Amy Taylor, Professor Feldstein concludes that "All three sets of estimates agree in placing the key price elasticity between −1.0 and −1.5. This value implies that the current deductibility of charitable gifts is a very efficient incentive, yielding more in additional gifts than the Treasury foregoes in potential revenue." In his simulations, reported in another of his papers, he employed a value for this price elasticity equal to −1.15 for all individuals in attempting to appraise the possible effects of various tax changes on average contributions by income classes extending from the lowest $0–5,000 per annum to the highest, $100,000 per annum and over. These quantitative predictions depend critically on, among other things, the particular value assigned to the price elasticity. The following points are particularly important in appraising the conclusion presented above and the results of the simulation calculations.

1. If the price elasticity were −1.15 for everyone or were within the range −1.0 to −1.5 for everyone, then indeed holding all else constant, the conclusion cited above, that "this value implies that current deductibility of charitable gifts is a very efficient incentive, yielding more in additional gifts than the Treasury foregoes in potential revenue," would be valid. Note that assuming the same price elasticity for everyone does not imply the same elasticity of charitable giving with respect to the marginal income tax rate. For example, a 25 percent increase in the marginal tax rate from 0.20 to 0.25 implies just a 6.25 percent decrease in the price of giving from 1−.20 = .80 to 1−.25 = .75. The fact that a given percentage change in the price of charitable giving is not the same as the corresponding percentage change in the marginal tax rate means that the absolute price elasticity is not equal to the elasticity of charitable giving with respect to changes in the marginal tax rate. In fact, with marginal tax rates rising with income, a price elasticity that is constant for all income levels mathematically implies a greater sensitivity of high-income givers to marginal tax rate changes than of low-income givers.[3] Given that many readers may think in terms of the sensitivity of charitable giving to marginal tax rate changes, it would be worthwhile to emphasize that a constant price elasticity does not imply a constant elasticity with respect to the marginal tax rate. In fact, it implies a greater response of high-income taxpayers to a given proportionate change in their marginal tax rate than of low-income taxpayers to the same proportionate change in their marginal tax rate.

2. While Professor Feldstein indicates a fairly large margin of uncertainty for his estimate of the price elasticity −1.0 to −1.5, this margin of uncertainty is probably not broad enough to reflect all uncertainties, particularly for low-income individuals. While each low-income individual does not contribute a great deal to charity, there are a large number of low-income givers and thus the group's total contribution is substantial. Given the evidence presented, it seems unwarranted to assume that the price elasticity for low-income individuals is equal to −1.15 as assumed in the simulations. Simply put, the price elasticities for different income groups have not been determined very precisely. For example, in Table 3 of the Feldstein-Taylor paper, the 1970 data give a price elasticity estimate of −0.35 with a standard error of 0.52 for the $4,000–20,000 income group while the 1962 data provide an estimate equal to −3.67 with a standard error of 0.45. These point estimates of −0.35 and −3.67 differ by about a factor of 10 and have very different policy implications. More work is needed to understand the sources of such variation in the estimates before they can be used confidently for serious policy simulations. Simulations based on various assumed values of the price elasticities for different income groups would be useful for determining the practical importance of the differences. Also more calculations to improve the form of the equation for charitable giving would be desirable.

3. The estimated price elasticity of charitable giving, −1.0 to −1.5, relates to all types of charitable giving. If the mix of types of charitable giving varies with income level and if different kinds of charitable giving have different price and income elasticities, the aggregate estimate of −1.0 to −1.5 is a very complicated average of the

underlying different price and income elasticities. This point deserves attention and analysis in order to obtain a better appreciation of the aggregate estimate, −1.0 to −1.5.

4. In Table 3 of the Feldstein-Taylor paper, there is some indication that the income elasticity of charitable giving increases with the level of income. This point deserves further study and provides a basis for being cautious about the results of simulations based on the assumption that the income elasticity is the same, and less than one, for individuals at widely different income levels. The aggregation effects mentioned in (3) above deserve consideration here too. Also, with respect to the calculations performed using current income and/or proxies for permanent income and wealth, the income elasticities of charitable giving with respect to "permanent" and "transitory" components of income should be set forth explicitly and discussed. This is important since changes in charitable giving may depend critically on whether an income change is viewed as being a temporary or a permanent change.

5. In connection with the calculations purporting to show the effects of changes in tax policies on the volume of charitable giving, more attention should be given to explaining exactly what "background" assumptions are being made in the simulations. The changes, computed from cross-section data pertaining to different individuals at a point in time, may approximate how individuals will respond to changes in tax policies through time. However, it can be that responses to changed tax policies through time can be different from those predicted by a cross-section analysis. Explicit discussion of this point would be helpful for readers to obtain a fuller understanding of the results of the simulation analyses.

In summary, Professor Feldstein and his associates have provided much that is valuable in understanding the quantitative determinants of charitable giving. That all findings are not as precise or as final as one would like is a usual state of affairs in many important investigations, for example the relationship between smoking and cancer incidence. I congratulate Professor Feldstein and his associates for their successful efforts in reducing the range of uncertainty about the relationship of charitable giving and its determinants.

Footnotes

1. The description of their test below equation (11) is not accurate.

2. In Table 3 of the paper by Feldstein and Taylor, it is seen that the income elasticity for 1962 has a value of .53 (s.e. 0.07) for the income class 4-20 thousand and rises substantially with income. For 1970, there is also a rise in the income elasticity with income.

3. Specifically, if $\log G = -\gamma \log(1-m)$, where $-\gamma$ is the price elasticity, we have $dG/G = -\gamma\left(\frac{-dm}{1-m}\right)$ $= \frac{-\gamma m}{1-m} \frac{dm}{m}$ and thus the elasticity of charitable giving, G, with respect to m is $\frac{\gamma m}{1-m}$

Note that the value of the factor $\frac{m}{1-m}$ rises with m from a value of 0 for m=0 as the following table indicates:

m:	0	.1	.2	.3	.4	.5	.6	.7	.8	.9
$\frac{m}{1-m}$:	0	.11	.25	.43	.67	1.0	1.5	2.3	4.0	9.0

CHARITABLE CONTRIBUTIONS UNDER THE FEDERAL INDIVIDUAL INCOME TAX: ALTERNATIVE POLICY OPTIONS

George F. Break †

Introduction

This paper discusses the most frequently suggested ways of changing the treatment of charitable contributions under the federal individual income tax. Arguments for and against each policy option are presented and analyzed, and quantitative estimates of both the aggregate revenue impact of the various alternatives and the changes they could be expected to make in the level of charitable giving are given. The distribution of these tax and giving changes by taxpayer income classes is also shown, and the impact of the changes in giving on different kinds of philanthropic institutions is summarized.

Two different sets of quantitative estimates are used. The first was provided by the Office of Tax Analysis, U.S. Treasury Department, and employs the 1970 Treasury Tax File updated to 1974. These estimates show the direct impact on Treasury revenues of a given tax policy change but do not incorporate any indirect revenue effects created by induced changes in charitable giving. For some policy options, such as elimination of the charitable deduction, this is no problem since there would be no indirect revenue effects, while for others the indirect effects, though present, would be relatively unimportant. In still other cases, however, the indirect effects would matter, and for them one needs a simulation model incorporating both the effects of stipulated tax changes on the amount of money given to charity by taxpayers at different income levels and the feedback effects on Treasury revenues of those adjustments in giving. Comprehensive estimates of this kind have been prepared by Martin Feldstein and his associates, using the 1970 Treasury Tax File, and these provide the data for most of the tables given below.[1]

The Feldstein studies provide a wealth of empirical information about the potential reactions of private donors to changes in the tax treatment of charitable contributions. In particular, they show high sensitivities on the part of such donors to changes not only in their disposable incomes but also in the terms on which their dollars can be given away. Under present law, a one dollar cash contribution costs taxpayers using the standard deduction one full dollar, whereas it costs those who itemize their deductions anywhere from $0.86 to $0.30. This price of giving, as economists call it, is even lower for high-income taxpayers giving appreciated property directly to charity, since the capital gains that have accrued on such assets are not under present law subject to income tax. That such tax-created variations in the price of giving could have important effects on the amount of giving has long been recognized, but early empirical studies implied that donors were highly insensitive to such price variations. This in turn suggested that the tax treatment of charitable contributions could be changed in various ways without causing much change in the behavior of donors. Whatever complacency may have been created by such beliefs, however, has now been shattered by the Feldstein studies.

The significance of the Feldstein findings – and it should be stressed that they have been derived by the use of much better data and the application of more precise and sophisticated econometric techniques than previous studies – may be seen by considering the benchmark case of a price elasticity of giving exactly equal to unity (-1.0). In technical terms, this means that a 10 percent increase in the price of giving would cause donors to reduce their giving by exactly 10 percent. In tax terms, it means that donors can always be expected to give the same amount of their own money to charities and simply add to those sums whatever help the Treasury offers them through the tax laws. When a 60 percent tax bracket donor gives $100 to charity now, the net cost (or price) to him is only $40 since his $100 charitable deduction reduces his federal tax liabilities by $60. If that deduction were eliminated and if his price elasticity of giving were unity, however, he would, according to this assumption, give only $40 to charity. The donee institution would therefore lose the $60 that the Treasury gained from the change in the tax law. Clearly, that kind of taxpayer reaction has to be taken seriously by policy makers. But even greater impacts on charities are possible. The Feldstein studies mostly produce price elasticities greater than unity, implying that a taxpayer might well respond to the loss of his charitable deduction by reducing his gift by more than the increase in his tax liabilities. In the example just used, the $100 contribution might be reduced to $30. Thus the charity would lose more ($70) than the Treasury would gain from the tax change ($60), and the taxpayer would end up with more disposable income than he had before. Tax increases on the rich that actually increase their disposable incomes are not easy to conceive of, but elimination of the charitable deduction might well be such an anomaly.

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Not everyone, of course, will be willing to accept the high price elasticities of giving produced by the Feldstein studies. Nevertheless, they are the best estimates available, and they are accordingly used to compare the quantitative effects of the different policy options discussed in this paper. Specifically, all of the changes shown in both aggregate giving and the amounts given by taxpayers in different income classes are based on a price elasticity of giving of -1.285 and an income elasticity of giving of 0.702, which are the preferred Feldstein values. It is believed that the resulting quantitative estimates may be used by policy makers with a high degree of confidence. Actual results might differ from those predicted by these estimates, but the differences are not likely to be great enough to change the general picture significantly. Somewhat less reliable than these aggregate forecasts are the more specific ones showing how different kinds of charitable institutions would be affected. This is because the Feldstein estimates of these effects are, of necessity, based on less comprehensive data.

Potential changes in the income tax treatment of charitable contributions are here divided into nine major policy options and are discussed in Chapter I. Chapter II deals with two mixed options that combine elements of the nine basic choices earlier dealt with.

I

MAJOR POLICY OPTIONS

Extend the Charitable Deduction to All Taxpayers

Treasury tax model estimates for 1974 indicate that 40 percent of federal individual income taxpayers itemized their personal deductions, and 60 percent took the standard deduction. The former group, who were the only ones able to deduct their charitable contributions for tax purposes, received about two thirds of both adjusted gross income (AGI) and taxable income and paid over 70 percent of the total tax. The first policy option would move the charitable deduction out of the personal deduction category and make it an "adjustment to income" deductible in the computation of AGI. In this way the deduction privilege would be available to all taxpayers, whether they took the standard deduction or not.

In principle, the case for this proposal stands or falls with the case for the deductibility of charitable contributions in general. One approach to this basic issue, which may be termed the purist case, argues on the pro side that deductibility is required because charitable contributions are not properly part of a tax base that seeks to measure personal abilities to pay. A tax geared to such a base, it is argued, would impose a uniform graduated burden on total personal consumption and accumulation, and charitable giving cannot realistically be included in either. Such gifts obviously do not increase the contributor's wealth, and unlike his consumption expenditures, which have as their object the taking of economic resources for his own exclusive use and enjoyment, charitable contributions make resources available to others, frequently on a nonexclusive basis. While private goods are suitable objectives for equitable income taxation, collective goods are not; and while all sources of income should be treated equally for tax purposes, uses should be defined and differentiated so as to arrive at a practicable definition of personal consumption plus accumulation.

This case, which is based on philosophical and economic considerations too complex to go into here,[2] is vigorously disputed by advocates of a comprehensive income tax base.[3] In their view all sources *and uses* of income should be treated equally for tax purposes, the only permissible deductions being those required to define net income accurately in the first place. Some uses of income, such as gifts and contributions, are admittedly made for the benefit of others, but it is contended that they must bring at least as much pleasure to the donor as other possible uses of his funds or they would not be made. The rebuttal to this is that the pleasures in question are entirely intangible and that no income tax can, or should, expect to include in its base all of the many intangible pleasures of life. Broadening the concept of personal consumption, and therefore taxable income, to encompass such elements would logically mean taxing things such as the value of volunteer services, the imputed value of housewives' work, and even leisure. This being the case, would it not be more equitable to confine the reach of the tax system to tangible consumer pleasures, the great majority of which can successfully be taxed?

These brief comments no more than touch the surface of a highly complex, technical debate. It is one that offers the policy maker much food for thought but no definitive answers. What is important is that those who have to make the decisions be aware of the fundamental nature of the dispute which envelops the question of how charitable contributions should be treated under the income tax. If such contributions are judged not to be a part of either personal consumption or saving, the solution is simple – they should be fully excluded from the income tax base, and any limitation on that principle must be justified by compelling countervailing arguments. If, on the other hand, charitable contributions are considered to be part of personal consumption, the issue is much more complicated. Acceptance of this view means making determinations as to whether specific private philanthropic activities are deserving of public support, whether this support should be provided through the government expenditure or tax system, and if the latter, which particular tax incentive is most efficient and desirable. Deductibility is one of a number of means by which the goal might be achieved.

The pragmatic case for full deductibility of charitable contributions draws on both of these contradictory lines of thought. On the one hand, it is argued that contributions are an ambiguous element in family budgets, not exactly the same as other kinds of consumption expenditures but not entirely different either. Some special treatment under the income tax is thereby suggested, though not necessarily full deductibility. On the other hand, it is argued that philanthropic activities are well worthy of government support, that the decentralized, pluralistic, individualistic system of choice created by tax deductibility has many attractions, that no clearly superior tax incentive scheme has yet been identified, and hence that deductibility, given its other attractions, is the best solution. Though not a clearcut choice when judged by the test of either the technical definition of taxable income or the most efficient public incentive, deductibility does have the political advantage of drawing support from both sides. No other policy alternative has such breadth of appeal.

Acceptance of full deductibility as the optimal income tax status of charitable contributions raises two main questions about the current federal law: (1) Is full deductibility now available to all taxpayers, directly or indirectly, and if not, how should it be made available; and (2) should any constraints be placed on full deductibility, and if so which ones? These two questions will be considered in turn.

The purist case for full deductibility requires only that all taxpayers be granted the privilege. However, if incentives are also an issue, as they are under the pragmatic case, consideration must also be given to non-taxpayers. Unfortunately, it is not clear how close the present federal income tax comes to meeting purist case goals. On the one hand, it may be argued that full deductibility is already extended to all taxpayers, directly for those who itemize and indirectly for those who take the standard deduction, because the latter is a proxy for itemization, adopted for simplification purposes, and its level is, or at least should be, set so as to include average charitable contributions at the lower income levels. On the other hand, it may be argued that direct deductibility is preferable to indirect and that it can be provided for all by moving the charitable deduction "above the line" without creating any significant administrative or compliance problems. This, then, is the first policy option to be considered.

Feldstein's estimates indicate that moving the charitable deduction above the line would have reduced 1970 federal individual income taxes by $1 billion and increased charitable giving by $1.2 billion, or 7 percent. Whereas gifts to religion would have risen by 8 percent, contributions to education and hospitals would have increased by only 3 percent. Tax reductions, of course, would have been concentrated in the lowest income groups, being 4 percent for those with incomes below $5,000, 2.5 percent between $5,000 and $10,000, 1 percent between $10,000 and $15,000, and negligible above that level.

Place Maximum Limits on the Charitable Deduction

The second question raised above concerns the possible need to place some kind of limit on the deductibility of charitable contributions. Under the purist case, of course, there is no such need since charitable contributions are not part of the tax base in the first place. If that base were comprehensively defined so as to include all elements of ability to pay taxes, there would be no need for purists to be concerned about the effects of full exclusion. Under a non-comprehensive tax, however, it is quite possible for a taxpayer with relatively large amounts of exempt, or partially exempt, income to contribute enough to charity to wipe out his tax liability entirely. Providing this kind of privileged status for some, by permitting them to contribute only to their own privately chosen public goods while everyone else has to contribute to collectively chosen public goods is an option of dubious merit. One way to constrain it is to place a ceiling on the deductions that a taxpayer can claim in any one year. Whether the present tri-level ceiling is adequate for this purpose will not be considered here. An important start toward evaluating it, however, can be made by weighing the revenue impact of lowering the basic 50 percent ceiling.

Treasury tax model estimates place the 1974 revenue gain from lowering the ceiling to 40 percent at $133 million, an amount that is only 0.11 percent of total tax revenues. For returns with itemized deductions the relative tax increase would be only slightly larger (0.16 percent), but it would, of course, be concentrated in the highest income groups (see Table 1). Perhaps more important than the revenue increase is the estimate that about 2,500 returns with itemized deductions that are now free of tax would be moved into the taxable category. This is not a large number, but it is about 3 percent of the returns with AGI of $1 million and over.

Another policy option, which deals more directly with the problem at hand, would be to restrict the charitable deduction to a maximum of one half of each

Table 1
Tax Effects of Lowering Ceiling on Charitable Contribut[illegible]eduction to 40 Percent, by Adjusted Gross Income Class, [illegible]4

AGI Class (in thousands)	Percentage Tax Increase	Percent of Nontaxable Returns Made Taxable
$0-10	0.00%	0.00%
10-20	0.01	0.00
20-30	0.01	0.03
30-50	0.01	0.00
50-100	0.08	0.07
100-500	0.48	0.27
500-1,000	1.78	0.48
1,000-2,000	5.30	3.11
2,500 and over	5.55	1.65

donor's "gross taxable income," derived for each itemizer by adding his charitable contributions to his taxable income as presently defined. Feldstein estimates that this would have increased 1970 individual income tax revenues by $46 million and reduced giving, mainly by those with incomes above $100,000 a year, by $74 million. Educational institutions and hospitals would have been the only donee groups suffering contribution losses as high as 2 percent.

Compulsory Allocation of Charitable Deductions

Still another approach to the present problem would be to require that each taxpayer's total charitable contributions be allocated to deductible and nondeductible categories in proportion to his receipt of fully taxable and tax preference income. Using for this purpose the 1969 minimum tax law's definition of preference income (minus the $30,000 exclusion but not the taxpayer's ordinary income tax liability), Feldstein's simulations place the 1970 revenue gain from compulsory allocation at $81 million and the induced reduction in charitable giving at $151 million. While the average contributions to religion or to health and welfare would not have fallen perceptibly, those to education would have gone down by 4 percent and those to hospitals by 3.5 percent.

Restrict Deductions for Appreciated Assets to Cost Basis

Compulsory allocations of the kind just discussed are based on the reasonable assumption that when income is earned, and expenditures made, in money, there is no way of matching particular sources and uses. A given cash contribution cannot be said to be made from either taxable or tax-exempt income because it may be presumed that the donor's behavior, though influenced by the toal *amount* of after-tax money income he receives, is not changed by shifts in the *composition* of that after-tax income. For cash contributions, then, it is perfectly reasonable to assume, as Policy Option 3 does, that the gifts come proportionately from taxable and nontaxable income.

In the case of gifts of appreciated property, however, specific allocation is possible. When a person gives to charity an $11,000 asset that he bought for $1,000, he is, under current tax law, contributing $1,000 of taxable income and

$10,000 of tax-exempt income. Specific allocation would restrict his charitable deduction for tax purposes to his cost basis of $1,000.

Few data exist on which to base estimates of the revenue and distributional effects of such a change in tax law. Treasury tax model tabulations, for example, do not separate contributions of property from carryovers of unused prior-year deductions. Since 1972 data show the division in that year to be 87 percent property contributions and 13 percent carryovers, however, it is here assumed that these proportions also apply to the non-cash contributions reported in other years. The errors introduced by this assumption should not be large, and they are certainly less troublesome than those created by lack of any knowledge of the portion of property contributions made up of unrealized appreciation in value. The procedure adopted here is to make two alternative assumptions that, we hope, bracket the true, but unknown, figure. In the first simulation shown in Table 2 it is assumed that one third of the value of contributed property is unrealized appreciation. This is equivalent to disallowing 29 percent (29% = .33 x 87%) of reported non-cash contributions. In the second simulation the assumption is that two thirds of the value of property contributions is unrealized appreciation, which is equivalent to disallowing 58 percent of recorded non-cash contributions.

Table 2

Revenue Effects of Disallowing Deduction of 29 Percent[a] and 58 Percent[a] of Non-Cash Charitable Contributions, by Adjusted Income Class, 1974

AGI Class (in thousands)	Disallowance of 29%[a] of Non-Cash Charitable Contributions		Disallowance of 58%[a] of Non-Cash Charitable Contributions	
	Amount of Tax Increase (in millions)	Percent Tax Increase on Itemized Deduction Returns	Amount of Tax Increase (in millions)	Percent Tax Increase on Itemized Deduction Returns
$0-10	$ 6.3	0.16%	$ 12.6	0.32%
10-15	5.7	0.06	11.3	0.11
15-20	11.7	0.08	23.8	0.16
20-30	15.8	0.08	32.2	0.16
30-50	17.7	0.13	36.0	0.27
50-100	31.5	0.27	66.1	0.58
100-500	93.5	1.07	196.2	2.24
500-1,000	25.0	2.67	51.9	5.54
1,000 and over	38.0	3.51	89.7	8.29
All classes	$245.2	0.29	$519.8	0.61

Source: Treasury tax model projected to 1974.

a. For derivation and meaning of these two percentages see accompanying text.

It is estimated that restricting deductions of appreciated assets to the donors' cost bases would increase federal income tax revenue by $245 million in 1974 if one third of the claimed market value of those assets is unrealized appreciation, and by $520 million if two thirds of the market value is unrealized appreciation. Tax increases on returns with itemized deductions would be minimal except for returns with AGI above $100,000 as Table 2 shows. For returns with incomes of $1 million and more, income tax burdens would be raised by 3.5 percent if one third of the value of contributed assets is unrealized appreciation, and burdens would rise by 8.3 percent if two thirds of the value is unrealized appreciation.

One difficulty with restricting deductions for appreciated assets to cost basis is that the form in which a charitable gift is made may be affected by tax considerations to the detriment of philanthropic activities. If the taxpayer with the $11,000 asset and a cost basis of $1,000 is in the 70 percent tax bracket, for example, his tax gain from giving it directly to charity would be only $700. If he first sold the asset and then donated the proceeds, however, his long-term capital gains tax would be $3,500 (assuming no effects either on his minimum tax liability or on the amount of his salary qualifying for the maximum tax), the tax reduction resulting from the cash contribution of $11,000 would be $7,700, and his net tax gain, therefore, would be $4,200. Clearly, he would prefer the cash transaction, but if the asset were of a kind particularly suited to the philanthropic organization, it would frequently prefer the direct gift of property (even if the sale were made subject to the condition that the charity have first refusal rights on any subsequent sale, the charity might have to wait a long time to secure the asset). Problems of this sort could be avoided by requiring constructive realizations for tax purposes of all accrued capital gains on contributions of property. Such a change in the law would make donors indifferent between cash and non-cash contributions since the tax consequences would be the same in either case.

Tax Unrealized Appreciation on Property Contributions as a Long-Term Capital Gain

The revenue effects of constructive capital-gains realizations for tax purposes on all direct contributions of property have been simulated on the basis of the same two assumptions used in the preceding section. This means that 29 percent and 58 percent of recorded non-cash contributions is assumed to be taxed as a long-term capital gain. Additional tax revenue in 1974 would be $114 and $240 million, respectively; and as shown in Table 3, the increases would be significant only for itemized deduction returns with AGI of $100,000 and more. As would be expected, the figures in Table 3 are about one half of the corresponding ones in Table 2, the only differences being that some taxpayers would be unaffected by the constructive realizations assumed in Table 3 because they would have unused capital loss carryovers.

That constructive realization of capital gains on charitable donations of property is a policy change that would have only a minor impact on Treasury revenues is confirmed by Feldstein's simulations using different assumptions about the relative importance of the accrued gains to be taxed and incorporating the feedback effects on revenues of donor reactions to the change. His estimates of 1970 revenue gains range from $180 to $370 million, and this would be accompanied by reductions in charitable giving of $350 to $460 million. Those reductions, however, would not be uniformly allocated by type of charity. While education and hospitals would experience losses of 7 to 8 percent, contributions to religion and health and welfare institutions would go down by only 1 to 2 percent. These estimates, moreover, may be on the low side if the leadership quality of large gifts of property is as important as many believe it to be. By setting an appropriate standard, it is argued, such donors induce others to give significantly greater amounts than they otherwise would. How important such demonstration effects may be cannot be quantified, but their undoubted existence should be kept in mind in assessments of the significance of Feldstein's estimates that constructive realization would reduce charitable giving by $1.25 to $1.97 for every dollar of additional revenue obtained by the Treasury.

Table 3

Revenue Effects of Taxing 29 Percent[a] and 58 Percent[a] of Non-Cash Contributions as Long-Term Capital Gains, by Adjusted Gross Income Class, 1974

AGI Class (in thousands)	Taxing 29%[a] of Non-Cash Contributions as a Long-Term Capital Gain		Taxing 58%[a] of Non-Cash Contributions as a Long-Term Capital Gain	
	Amount of Tax Increase (in millions)	Percent Tax Increase on Itemized Deduction Returns	Amount of Tax Increase (in millions)	Percent Tax Increase on Itemized Deduction Returns
$0-10	$ 3.4	0.09%	$ 6.7	0.17%
10-15	2.8	0.03	5.7	0.06
15-20	5.8	0.04	11.8	0.08
20-30	8.0	0.04	16.2	0.08
30-50	8.2	0.06	17.3	0.13
50-100	12.9	0.11	27.6	0.24
100-500	40.4	0.46	86.2	0.98
500-1,000	11.4	1.22	24.6	2.63
1,000 and over	21.0	1.94	43.7	4.04
All classes	113.9	0.13	239.8	0.28

Source: Treasury tax model projected to 1974.

a. For derivation and meaning of these two percentages see accompanying text.

Table 4

Revenue Effects of Eliminating the Charitable Contribution Deduction, by Adjusted Gross Income Class, 1974

AGI Class (in thousands)	Amount of Tax Increase (in millions)	Percent Tax Increase On:		Percentage Distribution of Tax Increases
		Itemized Deduction Returns	All Returns	
$0-10	$ 325	8.2%	2.1%	6.7%
10-15	519	5.1	2.4	10.7
15-20	658	4.5	3.2	13.6
20-25	519	4.2	3.5	10.7
25-30	343	4.3	3.8	7.1
30-50	662	4.9	4.5	13.7
50-100	661	5.8	5.6	13.7
100-500	759	8.7	8.5	15.7
500-1,000	142	15.1	15.0	2.9
1,000-2,500	133	23.3	23.3	2.8
2,500 and over	116	22.7	22.7	2.4
All classes	$4,835	5.7	4.1	100.0

Source: Treasury tax model projected to 1974.

Finally, it should be noted that constructive realization of capital gains on charitable donations of property is not a policy likely to be enacted in isolation. If adopted for charitable gifts, it will be asked, why should constructive realizations not also apply to all other gifts, as well as to property transferred at death? Certainly the impact on the amount of charitable giving would differ with the scope of the constructive realization policy adopted. Many uncertainties, in short, surround this particular change in the tax treatment of charitable contributions. Nevertheless, it does appear that increases in relative tax burdens would not be large, except for high-income donors, and that educational institutions and hospitals would be the main losers.

Eliminate the Charitable Contribution Deduction

All of the preceding policy options are consistent with the view that charitable contributions, by their very nature, are not part of a properly defined individual income tax. We turn now to options consistent with the opposing view that charitable donations are part of personal consumption, and hence of an equitable income tax base, and that special tax treatment of them is justified, if at all, only as a means of stimulating philanthropic activities. If it were decided either that private philanthropy needed no government support or that the support would best be given outside the tax system, by regular federal expenditure programs of some kind, the existing charitable deduction provision should simply be eliminated.

The Treasury tax model estimates that elimination of the charitable deduction would increase 1974 federal individual income revenues by $4.8 billion, which is 5.7 percent of the total tax liability on itemized deduction returns, and 4.1 percent of the tax liability on all returns. The distribution of these tax increases, by adjusted income class, is shown in Table 4. For itemized deduction returns, which are the only ones affected, the percentage increases in tax range from slightly over 4 percent on returns with AGI between $15,000 and $30,000 to 23 percent on those with $1 million and more. Whereas taxpayers with AGI below $10,000, who filed 57 percent of all returns in 1974, would pay less than 7 percent of the total tax increase, the top 1 percent of tax returns – those with AGI of $50,000 and more – would pay 37.5 percent. The policy would make 211,000 presently nontaxable returns taxable, the great majority of them (98 percent) having AGI below $15,000. The tax increase on these converted-status returns would be $80 million, which is 1.7 percent of the total tax increase of $4.8 billion.

Unlike all previously discussed policy options, elimination of the charitable contribution deduction would have a major impact on federal tax revenues. This means that other parts of the budget are likely to be affected as well, and this complicates analysis of all other economic effects of the policy change. The most important of these effects are those on the level and composition of private philanthropic activities, but they are likely to be quite different depending upon whether the higher tax revenues resulting from the elimination of the charitable contribution deduction induce matching federal tax reductions or increases in expenditures of one kind or another. Since the nature of these induced fiscal reactions cannot be predicted, attention at this point must be confined to the direct effects of eliminating the charitable deduction.

These effects depend critically on the sensitivity of giving to tax-induced changes in donor incomes and in the terms, or price, at which contributions may be made. Elimination of deductibility, of course, raises the price of giving to unity for everyone; that is, the cost of giving a dollar becomes a full dollar rather than a dollar minus the tax saving resulting from deductibility. Feldstein's standard estimates, which put the reduction in total giving at $1.29 for every dollar of increased revenue to the Treasury, imply, for example, that elimination of deductibility in 1970 would have reduced charitable giving by $4.6 billion, compared with the Treasury revenue gain of $3.5 billion. Perhaps even more important is the predicted composition of such a decline in charitable contributions:

Donee Category	Percentage Decline in Charitable Contributions[a]
Religion	22%
Education	49
Hospitals	46
Health and welfare	27
Other	33
Total giving	26

a. Simulations are for 1970 and are based on the Treasury tax model for that year. Included in the "Other" category are libraries, museums, musical, literary and scientific organizations, and zoos.

Finally, the paradoxical nature of these findings should be noted. If elimination of the charitable deduction would, as Feldstein predicts, induce donors to reduce their giving by more than their increased tax payments to the Treasury, such a change in the tax law would result in higher disposable incomes than before for many taxpayers, particularly at the highest income levels. Under such circumstances, elimination of the deduction would be progressive in its effects on individual tax burdens but regressive in its effects on personal disposable incomes. In Feldstein's standard simulation, for example, taxpayers with AGI below $50,000 would have very small increases in their disposable income (less than 0.5 percent on the average), but for those with AGI above $500,000 tax increases of 14 to 15 percent would be combined with higher disposable incomes averaging 5 to 10 percent.

Substitute a Single-Rate Tax Credit for the Charitable Contribution Deduction

If charitable contributions are regarded as part of the individual income tax base so that tax deductibility is not a matter of principle, and if private philanthropic activities are deemed worthy of government support, the basic choice is whether that support should be provided through the expenditure or the tax system. Those who favor collective determination of priorities in this area will prefer to rely on expenditure subsidies or on direct government operation of the activities in question. Those who favor individualistic, pluralistic choices could opt either for open-ended matching government grants to private philanthropies or for some kind of tax subsidy to donors. The former have the advantage of flowing directly to the organizations whose activities are to be encouraged, but involved a greater risk that the program would not long remain free of government controls.[4] Collective priorities, in other words, might gradually be substituted for the individualistic ones now operating through the tax system. How great these risks may be is impossible to say, but those who place a high value on individualistic philanthropic choices are likely to feel a good deal more comfortable with tax subsidies.

Given a choice of tax subsidies, the main question concerns the terms on which they should be offered to taxpayers. Several possibilities deserve consideration:

1. One of the most controversial features of the present deductibility privilege for charitable contributions is the set of variable subsidy rates that it offers to

taxpayers. Whereas takers of the standard deduction are given no price incentive at all to stimulate their giving and itemizers in the first tax rate bracket must themselves put up 86 cents of every dollar they donate to charity, donors at the top of tax rate scale need put up only 30 cents. This favoring of the rich over the poor is regarded by many as a blatant inequity of the deductibility system. Supporters of the system, on the other hand, reply that in the broader context of the proper role of private philanthropy in the society, it is progressive income taxation that creates the inequities in the first place. Deductibility, they argue, merely counteracts those inequities, and its job is to try to maintain the level and composition of private philanthropy that would prevail in the absence of a progressive federal individual income tax, which has clearly inhibited giving by the rich more than it has curtailed giving by the poor.[5] In technical terms the assumption is that for each tax bracket the negative income effect of the federal tax on charitable giving is approximately offset by the positive price effect of deductibility. Whether this is so or not, of course, is an empirical question, but supporters of the subsidy rate structure implicit in deductibility can always respond that it is the most plausible arrangement until the superiority of some other way of achieving the same goal is clearly demonstrated.

2. For the economist the optimal rate structure for the charitable contribution subsidy would be determined by the ratio of the external benefits of private philanthropy to the total benefits, both external and internal. Though donations clearly provide both pleasure to donors and more tangible benefits to the clients of the supported philanthropies, it cannot be assumed that the social value of the latter is always fully reflected in the former. When it is not, externalities are said to exist, and by acting on the basis of their own perceived benefits, donors will tend to undersupport the activities in question. These free-market inadequacies can be eliminated by having the government offer private donors subsidies whose rates are higher the greater the proportion of external benefits generated by the philanthropic activity in question. Appealing as this approach may be in principle, it is not yet, and may never be, capable of offering any precise policy guidelines. Nevertheless, it is a helpful rationale to have in mind. Relatively crude applications of it include the distinction made between eligible and ineligible charitable institutions in the provisions governing the tax deductibility of donations, and the lower (20 percent) ceiling on donations to private foundations. Further study of the mix of public and private benefits generated by different philanthropies might lead to a set of distinctions more sensitive to socioeconomic realities.

3. A subsidy rate structure with considerable appeal is one under which the government's matching contribution rate rises with the ratio of the private donor's contributions to his income.[6] This may be thought of as more efficient than a single-rate subsidy on the argument that, other things equal, private reluctance to give rises as the proportion of income donated increases. Or it may be regarded as more equitable, on the argument that donation of a larger proportion of one's income is more socially meritorious. One difficulty is that neither rational appears at present to offer any precise policy guidelines. Another is that the structure would be inconsistent with the economically efficient one if very large donations, because of their high public visibility, provided more private pleasure to donors than do small donations for the same purposes. A crude application of this general approach is the deduction floor proposal (Policy Option 9) discussed below.

4. A final possibility is to offer the same subsidy rate to every taxpayer by substituting a single-rate tax credit for the existing charitable deduction. This policy option has the obvious equity appeal of not discriminating among donors on the basis of income, as does deductibility. On the other hand, the credit would discriminate between donors of cash and donors of their own services, whereas

Table 5

Effects of Eliminating the Charitable Contribution Deduction and Substituting 25 Percent, 30 Percent, and 50 Percent Tax Credits, by Adjusted Gross Income Class for All Tax Returns, 1970

AGI Class (in thousands)	25% Tax Credit Percent Change in Tax	25% Tax Credit Percent Change in Charitable Contribution	30% Tax Credit Percent Change in Tax	30% Tax Credit Percent Change in Charitable Contribution	50% Tax Credit Percent Change in Tax	50% Tax Credit Percent Change in Charitable Contribution
$0-5	-13%	21%	-18%	29%	-50%	81%
5-10	-5	20	-7	31	-24	102
10-15	-2	12	-4	23	-16	92
15-20	0	3	-2	13	-11	72
20-50	1	-14	0	-5	-6	49
50-100	4	-45	3	-40	0	-4
100-500	8	-64	7	-61	4	-37
500-1,000	12	-74	13	-71	9	-51
1,000 and over	12	-70	11	-68	7	-49
All classes	-1	4	-3	13	-13	74
Amounts[a] (in billions)	$-0.72	$0.68	$-2.06	$2.30	$-11.03	$12.79

a. Before the policy change, tax revenues were $83.03 billion and charitable contributions were $17.32.

Source: Feldstein simulations based on the 1970 Treasury Tax File.

Table 6

Effects of Enacting an Optional 25 Percent Tax Credit for All Taxpayers and for Itemizers Only, by Adjusted Gross Income Class, 1970

AGI Class (in thousands)	All Taxpayers Percent Change in Tax	All Taxpayers Percent Change in Charitable Contribution	Itemizers Only Percent Change in Tax	Itemizers Only Percent Change in Charitable Contribution
$0-5	-13%	21%	-2%	4%
5-10	-5	20	-2	7
10-15	-2	13	-1	5
15-20	-1	5	0	2
20-50	0	1	0	0
50-100	0	0	0	0
100-500	0	0	0	0
500-1,000	0	-2	0	-2
1,000 and over	-2	-1	-2	-1
All classes	-2	12	-1	4
Amounts (in billions)	$-1.82	$2.08	$-0.56	$0.63

Source: Feldstein simulations based on the 1970 Treasury Tax File.

deductibility is neutral in this regard. When a person in the 60 percent tax bracket contributes $1,000 of his earnings to charity, for example, the net cost to him under deductibility is $400; similarly, if he earns $1,000 less in order to use that time to give his services to charity, the net cost is also $400. Under a 30 percent tax credit, however, his net cost would be $700 in the first instance but only $400 in the second. In this sense the tax credit may be said to discriminate against those whose personal services are not of high value to charities and who must accordingly contribute in cash if at all.

Shifting from deductibility to a tax credit would also have important effects on the level and composition of private philanthropic giving. Table 5, based on Feldstein's 1970 simulations, shows some of those effects. Shifting to a 25 percent credit, for example, would reduce Treasury tax revenues only slightly (by less than 1 percent) but would change individual tax liabilities substantially, raising those at the top of the income scale by about 13 percent and lowering those at the bottom by a similar percentage. Though total charitable contributions would not change much (an increase of only 4 percent), high-income donors would give much less and low-income groups would increase their contributions moderately. As a result, funds for hospitals and educational institutions would fall off by 22 and 25 percent, respectively, while giving to religious institutions would rise by 10 percent and to health and welfare organizations by 3 percent.

The downward pressures on giving to hospitals and education created by a shift to a charitable tax credit could be avoided by increasing the amount of the credit, but only at the cost of considerable loss of revenue to the Treasury. A 30 percent credit, shown in the middle columns of Table 5, would reduce tax revenues by $2.1 billion (2.5 percent) and raise total contributions by $2.3 billion (13 percent), but Feldstein's simulations show that hospitals and education would still suffer donation losses of 15 to 17 percent while religion gained 20 percent. A 50 percent credit, in contrast, would increase giving to all major groups of charities—by 30 to34 percent for hospitals and education, and by 74 to 85 percent for health and welfare organizations and religion. As Table 5 shows, however, the revenue cost of the 50 percent credit would have been $11 billion in 1970.

Enact an Optional Tax Credit for Charitable Contributions

The propensity of different income groups to give to different kinds of charities presents policy makers who regard the present charitable deduction as a tax subsidy, or tax expenditure, with a potentially difficult tradeoff. The more the tax subsidy is equalized for all taxpayers, the greater will be the reallocation of funds among different charities, and these changes may not satisfy criteria of either economic efficiency or political feasibility. Moreover, as long as the price elasticity of charitable giving exceeds unity, lowering the charitable tax subsidy for the wealthy and raising it for the middle and lower income groups would, contrary to standard expectations, increase the disposable incomes of the wealthy and reduce those of the other income groups.

If concern for the vigor or private philanthropic support for education and hospitals is important, enacting an optional tax credit for charitable contributions would satisfy that concern while moving the structure of tax subsidies toward equality. Feldstein's 1970 simulations, for example, show that an optional 25 percent credit, extended to all taxpayers including those taking the standard deduction, would increase giving to hospitals and education by 4 percent and to religion and health and welfare by 11 to 14 percent. The 1970 revenue cost of this policy option would have been $1.8 billion, with most of it, as Table 6 shows, concentrated in the lowest income groups. If an optional credit of 25 percent were offered to deduction itemizers only, however, the revenue cost would have been only $559 million, distributed in much the same way as the broader credit (see Table 6). Giving to hospitals and education, in this case, would have risen by 1 percent and to religion and health and welfare organizations by about 4 percent. The case for the more restricted optional credit, for itemizers only, would rest on the canon of tax simplicity. For this purpose the standard deduction would be made available to many low-and middle-income taxpayers and would be set high enough to include an allowance for average levels of charitable giving by these groups.

Table 7

Effects of Optional 30 Percent and 50 Percent Tax Credits, for All Taxpayers and for Itemizers Only, on Income Tax Revenues and Charitable Contributions, 1970
(in billions of dollars)

Optional Tax Credit	Income Tax Revenues	Charitable Contributions		Percentage Increase in Contributions to:	
		Amount	Percent	Hospitals and Education	Religion and Health and Welfare
		Credit Granted to All Taxpayers			
30%	$ -2.96	$ 3.45	20%	8%	19-22%
50%	-11.41	13.26	77	42-44	76-83
		Credit Granted to Itemizers Only			
30%	-1.31	1.53	9	4	9-10
50%	-7.17	8.38	48	32-34	50-52

Source: Feldstein simulations based on the 1970 Treasury Tax File.

The tradeoffs inherent in moving the charitable tax subsidy closer to equality for all taxpayers, by means of an optional tax credit, are shown in Table 7. While higher optional credits may improve interpersonal tax equity, they also cost increasing amounts of Treasury revenue and may stimulate philanthropic giving more than is socially desirable. Moreover, the higher the optional credit rate considered, the less reason there is to prefer it to a straight substitution of an equal rate tax credit for the present deduction. This is because the latter policy, which is always superior on equity grounds, has effects on giving that diverge less and less from those of an optional credit as the rate of the credit is increased. At the 50 percent credit level, for example, the two policies have the following effects:

Policy Option Granted All Taxpayers	Income Tax Revenues (in billions)	Charitable Contributions (in billions)	Percentage Increase in Contributions to:	
			Hospitals and Education	Religion and Health and Welfare
50% optional tax credit	$-11.4	$1[illegible].3	42-44%	76-83%
50% credit substituted for present deduction	-11.0	12.8	30-34	74-83

Place a Floor Under Deductible Charitable Contributions

A proposal with wide support, both as a means of stimulating philanthropic giving more efficiently than does the present tax law and as a way of rewarding particularly meritorious social behavior, is to restrict the deductibility of charitable contributions to those that exceed a certain amount or a specified percentage of adjusted gross income. In support of this proposal, it is argued that charitable contributions that are a small proportion of the donor's income may be regarded as so routine and ordinary that they would be made whether there is a government subsidy or not. If this is so, the efficient incentive policy is to restrict deductibility (or a tax credit) to contributions above the critical income percentage. Unfortunately, there is little empirical evidence that one might use either to set the level of the percentage floor or even to determine whether or not there is a sharp distinction between routine and discretionary charitable contributions in the first place. Moreover, the standard deduction prevents tax returns from providing a source of information about the charitable giving of lower income groups.

Given these uncertainties, the 1970 Treasury tax model has been used to simulate a number of different alternatives. The effects of three of these policy options are shown in Table 8. The first, involving a relatively modest floor on charitable deductions of $100 a return, would increase Treasury revenues by $0.9 billion, reduce total giving by $1.2 billion, and allocate that reduction of 7 percent fairly evenly over all major categories of charitable institutions. The pattern of tax increases would be uniformly regressive over the income classes shown in Table 8, but given Feldstein's elasticity estimates, these increases would be fully offset by reductions in contributions, so that no income class would end up with a lower disposable income. In that sense the $100 floor would have a strictly proportional tax burden incidence.

Table 8

Effects of Enacting Alternative Charitable Deduction Floors, By Adjusted Gross Income Class, for Itemized Deduction Returns, 1970

AGI Class (in thousands)	$100 Floor		$500 Floor		2% of AGI Floor	
	Percent Change in Tax	Percent Change in Charitable Contributions	Percent Change in Tax	Percent Change in Charitable Contributions	Percent Change in Tax	Percent Change in Charitable Contributions
$0-5	1.5%	-2.7%	2.7%	-5.0%	1.3%	-2.3%
5-10	1.4	-6.5	3.0	-14.2	1.9	-8.9
10-15	1.2	-8.2	3.0	-19.3	2.3	-15.1
15-20	1.2	-9.1	3.1	-24.3	2.7	-21.3
20-50	1.0	-8.8	3.1	-27.7	3.3	-29.8
50-100	0.7	-7.7	2.5	-28.9	3.9	-45.7
100-500	0.4	-3.2	1.6	-13.0	5.3	-44.0
500-1,000	0.1	-0.6	0.5	-2.6	6.7	-39.8
1,000 and over	0.0	-0.2	0.2	-0.8	4.9	-34.0
All classes	1.1	-6.8	2.9	-17.5	2.8	-17.2
Amounts (in billions)	$0.92	$-1.18	$2.37	$ -3.04	$2.32	$ -2.98

Source: Feldstein simulations based on the 1970 Treasury tax model.

The second policy option, using a higher floor of $500, would increase tax revenues by $2.4 billion in 1970, reduce total giving by more than $3 billion, and spread that 18 percent reduction fairly evenly over different donees, the cuts ranging from 17 percent for religion to 21 for hospitals. The pattern of tax increases, shown in Table 8, is roughly proportional up to an AGI of $50,000 and regressive thereafter, but again the amount of philanthropic giving would fall off enough to raise disposable incomes for all AGI classes slightly, none of the increases being larger than .3 percent

An alternative kind of deduction floor, similar to that now used for medical expenses, would be one proportional to adjusted gross income. The Feldstein simulation for a 2 percent floor, shown in the last columns of Table 8, estimates a revenue increase of $2.3 billion and a reduction in total charitable giving of $3 billion. This 17 percent reduction, unlike the one of comparable size for the $500 floor, would not be spread evenly among donee institutions. Whereas education and hospitals would suffer fund losses of 30 percent, health and welfare organizations would lose 18 percent and religion only 14 percent. While the pattern of tax increases is steadily progressive up to an AGI of $1 million, disposable income changes would be insignificant below $100,000 and would show average increases of 1 percent, 3 percent, and 5 percent, respectively, for the three AGI classes above that level shown in Table 8.

A troublesome problem with the use of charitable deduction floors is the incentive they provide taxpayers to bunch their contributions in specific years. Enactment of a 2 percent of AGI floor, for example would induce a taxpayer who customarily gave 2 percent of his income each year to charity, but for whom the change would mean loss of all deductibility for his contributions, to think carefully about changing his pattern of giving to, say, 0 percent, 0 percent, 6 percent or some other uneven distribution that would maximize the tax-saving value of a given amount of long-term giving. Such changes in the timing of giving would be much more feasible for the wealthy than for the middle and lower groups, and unless effective constraints were written into the new deduction floor law, the equity of the policy change would be questionable. To be effective, in other words, this year's deduction floor must be a function not just of this year's income but also of past levels of both income and charitable giving. Similar problems, it may be noted, would apply to government grants with matching percentages based on the proportion of income contributed by private donors each year. Whether these difficulties can be resolved at acceptable administrative and compliance costs is still an open question.

II

MIXED POLICY OPTIONS

The options described above would not necessarily have to be adopted in the pure forms described, but elements from two or more of them might be combined into a single tax reform package. To illustrate the possibilities, two mixed policy options may be considered explicitly.

The first, shown in the first two columns of Table 9, combines extension of the charitable deduction to all taxpayers with the imposition of a $100 floor. The opposing revenue effects of these two changes more or less cancel each other, the net increase in tax burdens being only 0.6 percent in the aggregate and close to 1 percent only for taxpayers with adjusted gross incomes between $15,000 and $50,000. Less complete offsets occur for charitable gifts, the disincentive effects of the floor dominating at all income levels. On the other hand, extension of the deduction does moderate those disincentives, especially at the lower income levels. Whereas the floor alone would induce taxpayers with AGI between $10,000 and

Table 9

Effects of Two Mixed Policy Options on Tax Revenues and Charitable Contributions, By Adjusted Gross Income Class for All Returns, 1970

AGI Class (in thousands)	Extend Deduction to All Returns; Enact $100 Floor		1% AGI Floor Plus 25% Tax Credit All Returns	
	Percent Change in Tax	Percent Change in Charitable Contributions	Percent Change in Tax	Percent Change in Charitable Contributions
$0-5	0.5%	-1.0%	-7.8%	13.2%
5-10	0.5	-2.3	-1.5	6.4
10-15	0.6	-4.0	0.4	-3.6
15-20	0.9	-6.7	1.3	-13.0
20-50	0.8	-7.5	2.5	-27.8
50-100	0.6	-7.1	4.6	-54.7
100-500	0.4	-2.9	8.1	-68.7
500-1,000	0.2	-0.5	13.6	-76.2
1,000 and over	0.0	-0.2	12.2	-72.5
All classes	0.6	-4.0	1.2	-9.1
Amounts (in billions)	$0.53	$-0.69	$0.98	$ -1.57

Source: Feldstein simulations based on the 1970 Treasury tax model.

$15,000 to reduce their giving by 8.2 percent (Table 8), the floor plus extension would reduce their giving by only 4 percent (Table 9). Aggregate giving would also drop by 4 percent, and this reduction would be spread uniformly over all recipient groups.

The second mixed policy option, shown in the last two columns of Table 9, combines a 1 percent of AGI floor with a 25 percent tax credit. This would increase Treasury revenues by nearly $1 billion, and these tax changes, which would be negative in the lower income levels, would be distributed progressively by income class except for the very top. Induced changes in charitable giving, however, would keep taxpayer disposable income virtually unchanged below an annual AGI of $100,000, and above that level disposable incomes would rise by 1.7 percent between $100,000 and $500,000, by 4.5 percent between $500,000 and $1 million, and by 9.4 percent above that level. Significant relative changes in charitable contributions would occur at all income levels, ranging from increases of 13 percent at the bottom to decreases of over 70 percent at the top (Table 9). Though the drop in aggregate giving would be only 9 percent, education and hospitals would lose 33 to 35 percent while religion would lose only 4 percent.

Footnotes

1. Martin S. Feldstein, "The Income Tax and Charitable Contributions: Part I – Aggregate and Distributional Effects, and Part II – The Impact on Religious, Educational and Other Organizations," *National Tax Journal* (March 1975 and June 1975); Feldstein and Charles Clotfelter, "Tax Incentives and Charitable Contributions in the United States: A Microeconometric Analysis," paper prepared for the Commission on Private Philanthropy and Public Needs, 1975; and Feldstein and Amy Taylor, "The Income Tax and Charitable Contributions: Estimates and

Simulations with the Treasury Tax Files," paper prepared for the Commission on Private Philanthropy and Public Needs, 1975.

2. See, in particular, William D. Andrews, "Personal Deductions in an Ideal Income Tax," *Harvard Law Review*, Vol. 86 (December 1972), pp. 309-85; and Boris I. Bittker, "The Propriety and Vitality of a Federal Income Tax Deduction for Private Philanthropy," in Tax Institute of America, *Tax Impacts on Philanthropy* (1972), pp. 145-70.

3. A concise and cogent presentation of this point of view may be found in Stanley S. Surrey, *Pathways to Tax Reform* (Cambridge: Harvard University Press, 1973), pp. 223-32.

4. For a detailed analysis of government grants for these purposes, see Paul R. McDaniel, "Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction," *Tax Law Review*, Vol. 27 (Spring 1972), pp. 377-413.

5. It may be noted that a major reason for inaugurating the charitable contribution deduction in 1918 was to protect private philanthropy from the effects of higher wartime tax rates. See C. Harry Kahn, *Personal Deductions in the Federal Income Tax* (Princeton University Press for the National Bureau of Economic Research, 1960), Chapter 4.

6. One example is the plan proposed by McDaniel, op. cit., p. 397.

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Part II

Foundations

THE PUBLIC FUNDING AGENCY

Eric Larrabee [†]

One might well trace, over more than a century, the transfer of social endeavor from the private to the public sector. To replace the robust communality of the colonies, where need could be treated in common (and the church often was the state, for that matter), there had to be choices made between individual initiative and government. One by one – in transportation, education, conservation, recreation – private routes were discarded and public ones adopted. Events as remote from one another as the replacement of turnpikes by public roads, the near-elimination of the proprietary medical schools, the development of the Forest Service and of extensive state and national parks – all might be considered, without stretching the point too far, as variations on a common theme: one of trial, error, and trial again.

Motives varied. Typically the transition followed upon the discovery or recognition that wished-for social ends could not be reached through the market system, either because they had become too expensive for the voting majority to afford, or because the field was one in which competition was irrelevant or ineffective, or because self-evident desirable standards of quality or safety were being sacrificed. In some instances government was able to render an activity economic by converting it into a monopoly, as in the early days of public transportation, when railroad rights-of-way or streetcar franchises were gifts of considerable value to the recipient. In others it brought institutions into being by extending indirect benefits, as with the land-grant colleges, while in still others it became itself the operating agent. In recent years, however, through the mechanism with which this paper is concerned, government has conveyed monies directly to existing institutions, for purposes in which those institutions were already engaged. It has done this through what might be called public foundations, or Public Funding Agencies.

Conspicuously, the fields in which they operate include scholarly, scientific, and medical research – including those aspects of higher education that are research bound – and culture, or the arts, as broadly defined (most examples herein will be drawn from the latter, since this has been the author's principal concern for the past five years). The most striking feature of this new domain for government, therefore, is that it was previously occupied, and continues to be occupied, by private patrons and private foundations whom no one – least of all government – wishes to see withdraw. Though it may be true that in these areas private sources of support can no longer bear the full burden, or respond fully to increased demand, and thus it may also be true that government has been drawn in out of necessity, it would most definitely not be welcome or useful for government to take over entirely, or even to dominate. The virtues of pluralism and voluntarism need not be labored at this juncture, other than to point out that government is by no means universally believed to be capable of replacing them. In this matter it is the public sector, and not the private, which is under pressure to prove itself.

Public funding of this kind very often serves as a forced supplement to that of the individual patrons and foundations who previously carried the load, and it is very properly still under scrutiny as such. Public funding agencies and private foundations bear certain superficial resemblances to one another, since the former often behave in the style of the latter, from whom they early adopted much of their theory and technique. But there are fundamental differences. The money that a public agency has at its disposal is renewable on an annual or periodic basis, and subject to governmental review, both executive and legislative. Once it is "locked in," in the terminology of the political process, there is reason to suppose that it will continue, but there is no certainty. The political climate for scientific research has been notoriously unstable, to the considerable discomfort of those whose careers were committed to it. The temptation to suppose that public money and interest on endowment are the same thing must be resisted.

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Public money is also firmly wedded to public service. All funding comes with some sort of string attached [illegible] in this instance the string more binding than all others is that which ties the organization asking for funds to a demonstrated sense of public duty or obligation. Within limits, a generalized social purpose will serve, since it must have been sufficiently compelling to produce a favorable reaction from voters and their elected representatives in the first place. Scientific research and the existence of museums or symphonies have come to be thought of as so defensible in principle as to be secure from that quarter. Most of the questions which arise relate to quantity or gross configurations of distribution; normally the ideological umbrella covers all. On those rare occasions when any specific funding decision is disallowed politically, this outrage can be protested successfully if the funding forms a part of a larger pattern of support which has the public's blessing. But the implication is inescapable that service to the public is part of the bargain.

From this flows a paradox – or, rather, a series of paradoxes. The mandate of public service is very broad, perhaps as broad as can be imagined in a highly organized and compartmentalized society. There are very few things that a public funding agency seriously wants to do for which a public service rationale cannot be found. All claims, until proven otherwise, are legitimate. If Syracuse, why not Bedford-Stuyvesant? If the Metropolitan Museum, why not the Earth People's Park? If Lincoln Center, why not the Videofreex? The potential range of activity enormously enlarges itself. The imagination of the potential donor is liberated by the assumption that his gift has been, in effect, validated in advance by its political referrent. Contrary to what one might expect, therefore, the public-service requirement has the opposite of a restricting effect on initiative and innovation.

The second paradox is that the public funding agency can, if it has the willingness and fortitude, take a strong position on the side of quality. The claims of every supplicant for funds are plainly not equal, nor do all of them equally advance those goals for which the political process has made the funds available – a proposition quick to be understood and accepted by the political mind. From many other analogies politicians readily appreciate that the pie must somehow be divided in a way which can be described beforehand and explained afterward. An easy out is to fall back on quotas and formulas, and in numerous fields – of which education is the most notable – this is the pattern which all-too-much government support has previously followed. But the fields to which public funding agencies contribute are new enough governmentally, and have themselves a strong enough tradition of quality control, so that there the issue is still open. It is vulnerable to challenge (a point to which we shall return), but it is not foreclosed.

A third paradox is that government funding has proved to be more ready, if not yet wholly able, to take on a problem that private giving has been either reluctant – or, as a matter of principle, unwilling – to engage: that of outright, long-term subsidy. The ideal of public service requires, among other things, that the needs of the supported organizations be defined at least to some degree as the organizations themselves define them. Their priorities must be taken seriously, and it has proved useful on occasion for them to play a part in framing whatever published criteria and guidelines the agency employs. High on the list any organization would write is the need for basic operating funds, and a familiar criticism of private giving over the years has been that it tends to focus on projects and isolable programs to the exclusion of the dreary, day-to-day demands which eat up income and build up deficits. To this complaint, at long last, the public funding agencies have in recent years begun to address themselves.

Finally, by the very virtue of their being "public," the public funding agencies are embedded in a complex system of interactions with their social, economic, and political environment which are constrictive in principle but often supportive in practice. That the agencies are not wholly independent, that they cannot act arbitrarily, that in fact they can scarcely function at all apart from their dense and nutritive context – these are sources of strength. The very existence of a public funding agency represents a high degree of commitment on the part of the society which sets it up, and this forms a reservoir of confidence and good will which can be drawn on, when necessary, to validate both purposes and performance. By the same token, of course, if the system is not responsive and fully deployed, no amount of merit or energy on the part of the agency alone will avail. If the several elements that make up the system are out of balance, no amount of protecting one from another – of attempting to purify the process, so to speak, by deflecting the forces which come to bear on it – will salvage the goal of wise funding decisions. The agency itself cannot be made more effective, or safer from abuse, by isolating it. Malfunctions in the system come about when one of the component parts fails to perform its function, performs it badly, or seeks to perform it in such a way as to dominate or neutralize the others.

Reduced to brief outline, a characteristic pattern would be somewhat as follows. The overall size and shape, the matrix, of the public funding agency's operation will be determined by its sponsoring political entities, both executive and legislative, who will make funds available, together with some statement as to how they are to be spent. A more detailed spending program will have been prepared by the agency, both staff and governing board, often subject to review and approval by the executive or legislative. Specific funding recommendations will be generated by the agency staff, which will have assembled information about the field involved and analysed requests or applications from those desiring funds. The question of merit – scientific, scholarly, or artisitic – will be passed on by a panel of professional advisers, convened for the purpose. Their recommendations combined with those of the staff will go to a governing board, council, or commission for final ratification. Funds will then move to the constituency to be served, to provide those services to the public for which the agency was created.

Thus far, and so baldly stated, there is little contrast here to procedures that have prevailed in private giving for a long time. The total number of elements in the system is five, and one may visualize them in a rough-and-ready sequence according to a hypothetical progression of control over the funds. The decision-point moves from political matrix to agency staff to professional advisers to governing board to constituency. But the distinctive feature, and it makes a vital difference, is that the sequence returns on itself, for it is the constituency that continually creates and recreates the political matrix. Only if the constituency is large and vocal will the votes be there. This is the most fundamental, and also the most formidable, of the interactions among the five elements, since it links the two most powerful in a bond full of possibilities for achievement and disaster.

It is not invariably necessary for a public funding agency to be structurally a part of government in order to behave in the manner described. Many variations are possible in which the agency, while retaining considerable independence, becomes the designated or chartered instrument of its parallel governmental entity. In the cultural field, for example, a number of county governments have made substantial funds available to county arts councils or cultural associations, with the acknowledged purpose of removing the burden of decision from government and placing it in the hands of a body regarded by the public as competent. A similar purpose underlies the creation of "districts" or "authorities," which seem particularly appropriate when they handle a sequestered fraction of tax revenues, as in the case of the St. Louis Museum, which receives city and county funds from something called the Metropolitan Zoological Park and Museum District, which itself receives nine cents on every one hundred dollars of assessed property evaluation. (I am setting aside the conceivable eventuality of a cultural authority having bonding powers, in order to fund capital expenditures, though in some quarters this is thought to be badly needed.) What will be described below is, therefore, less in the way of any universal rule than of a model or type-case situation through which the strengths and weaknesses of the public funding agency as a phenomenon can be evoked.

I use the word "matrix" in respect to the political component because it seems to describe best the formative and shaping character of political actions. What the agency sees itself surrounded by is not so much a legal and organizational framework as the sum total of a series of decisions and votes which have their own fluid and continuous life. They do not rest long in one place and they do not cease, but their cumulative impact is always present and forcefully felt. From the agency's point of view one of the worst aspects of the political process is this ongoing commitment of the prolongation of issues, this instinctive abhorence of any resolution which makes further political action at a later date unnecessary. Perhaps this is the inevitable reaction of the professional who comes to government as a hired hand. After a lifetime spent in the role, George Kennan could only say: "Where others saw a stage on which momentous issues were being dramatically resolved, I saw only a sordid, never-ending Donnybrook among pampered and inflated egos . . . (*Memoirs: 1950-1963* (1972), p. 322.)

The initiative behind a public funding agency will normally come from the executive, though this is not invariable or prerequisite. If the constituency is massive and loud enough, the agency and its cause will acquire one or more champions in the legislative, who will stand up for its interest and organize the defense of its budget. Politically speaking, this is normal and well-understood behavior, in no way resented by other politicians who are engaged in doing the same thing with other issues and are grateful to have a colleague to turn to when issues concerning the agency come up. The legislator must be willing, on the other hand, to be personally identified with the agency's purposes, which is not true of the executive, who need only regard those purposes as politically defensible or at least expedient and make his endorsement known. An extreme view is embodied in Heckscher's Law (named after its inventor, August Heckscher, Commissioner of Parks, Recreation, and Cultural Affairs, New York, 1967-73) which holds that culture always prospers all the more under statesmen who never heard of it before assuming office.

The actions of both the executive and legislative are descriptive rather than prescriptive. The formative function is most legitimate and efficient when it restricts itself to controlling the size and scope of the agency's operation and to setting forth in only general terms its objectives and the criteria it should use. Legislation that attempts to construct or prescribe the machinery of implementation infringes on the functions of other component parts of the system, and forces them into imbalance. The phrase "legislative intent" reflects the valid notion that laws passed for a specific purpose need not encode and program every device for putting themselves into effect; what matters is that the purpose be clearly expressed. Well-drafted legislation leaves no doubt in the minds of the executive as to what is intended to be executed, and it can have great usefulness and value. In the ideal legislative process, the intentions of the executive and the doubts and reservations of the legislative will have been hammered into some kind of compromise, which will have the authority and persuasiveness natural to metal capable of surviving such tempering. The mandate of a public funding agency can have force in proportion to the intensity of the fires in which it is forged.

It goes without saying that a precondition of favorable action on public funding is that its purpose shall have been recognized as politically compelling, preferably on a nonpartisan basis, as most often has been the case with funding for the arts or scientific research. Doubtless there is an aspect of fashion here; after Sputnik, higher education could do no wrong (less so now), and within the past five years the arts have enjoyed rapid escalation (less so now). But the absence of partisanship has been a hopeful omen, and will probably remain so as long as public desire for the services being funded continues at its present level and continues to express itself. For the long haul, direct opposition seems likely to come mainly from those who believe public funding of all kinds to be excessive, or during those periods when high taxation and budget reduction become violent political issues. In normal times the most immediate question will be that of who gets the credit.

Quantity is another matter. It will be debated out of all proportion to its importance, or of any relationship between the debate and its ultimate outcome. The periodical renewal of the funding has the effect of making it permanently discussable. Like all political budget contests this is an exercise in pressure and counter-pressure. Knowledge of the actual need may be quite extensive in the constituency, the agency staff, or budget professionals in the executive branch and in the legislative committee staffs, but the final figure will be less affected by all their expertise together than by the forcefulness of the executive and the sensitivity of the legislative to public interest and involvement. Not that this is scandalous or necessarily deplorable, since it often produces the required results, but it does turn back upon the funding agency – its staff and its board – an obligation not only to be politically active and resourceful, but to do all they can of the large-scale budgeting, the cost accounting of long-term goals, which the political process, unaided, cannot aspire to perform.

The ritual of periodic reaffirmation requires that there be, at each new funding cycle, a public struggle in which the agency measures itself against other departments of government and their competitive calls upon the public purse. The annual (or whatever) budget battle is the largest fact in the life of the agency administrator. For more than half, or even as much as three quarters, of his year to be consumed by it would not be exceptional. Having persuaded the executive to endorse its budget request, which is the first task, the agency must then mobilize – without appearing to do so, since this would presumably be illegal – all the power of its constituency to influence the legislative. Letters must be written, telegrams sent, phone calls made, interviews requested and conducted – literally by the tens of thousands in a state the size of New York. And all this strenuous, time-consuming expenditure of effort has only what might be called a negative-positive effect; that is, for the effort to be there is of no great consequence, but for it *not* to be there is fatal.

The expression of public opinion has the effect on politicians of enabling them to consider a proposal on its merits. As long as no one is for it, they cannot possibly be for it; but as soon as enough strong voices have spoken in its defense they can safely begin to think about it dispassionately. Setting rhetoric aside, their actual concern is also less likely to be about the total sum than about the manner in which it is spent. They will want to know that it is prudently administered. They will want to know that it is not merely stimulating increased need which they will then be asked to meet next year. In the case of the public funding agencies most especially, they will want to know that government money is not going to have the effect of drying up the previous flow of funds from the private sector. In New York State this concern produced a so-called "maintenance of effort" clause in the annual appropriation act for the arts, requiring evidence that state funding would not "substitute for or replace" that from "customary" non-state sources – wording which the state arts council staff managed to have modified into a far more mild and flexible form than many legislators wished (and in this, a significant indication of their attitude).

Politicians have constituents, and constituents are known to exert themselves on their own behalf, with the result that both legislators and executive may be tempted to intervene with the agency in order to increase their own aura of power and competence. Since the greatest fears of abuse attach to this danger of improper influence on specific funding decisions, it is well to note that in contemporary experience examples of it are usually rare or minor enough to be tolerated. Firmness on the part of the governing board and vigilance on the part of the constituency are the only ultimate safeguards, though there are elements in the normal political make-up that can serve as reinforcement. First of all, the politician is far more interested in the appearance of administrative supervision than in its reality. Administration is not his native province, nor is it to his advantage to gather unto himself any more decisions – with their invariable consequence of offending *somebody* – than he can conveniently avoid. The reputation of being a pipeline to decision is not one he craves, since pipelines are difficult to turn off. In the presence of a constituent he may storm and bluster, but in private he may just as well be sympathetic and understanding about the agency's dilemma, since it is so like his own. The time when he is serious, and must be taken seriously, is when he speaks for his district. Far more common than individual interventions are reminders of the agency's responsibility to a particular section, often geographic, of its constituency. Such pressure as this is not only legitimate but often helpful, since it can serve to counter-balance other pressures and to illuminate the agency's routines in a legislative context.

One other, and by no means negligible, function of the political entities is to make or to approve appointments to the agency governing board and staff. As for the latter, it is essential that both the executive and the legislative refrain from using public funding agencies as dumping grounds for political job-placement; the principle of professionalism must be accepted at the outset and vigorously maintained, on the grounds that its sacrifice is a potential source of embarrassment more serious in the long run than any short-run loss in patronage. Since most public funding agencies are engaged in fields where professionalism is obviously called for, there should be no hesitation in asserting this principle. Here the many precedents in government for precise job definition will stand the agency in good stead, and the worst inroads of civil service can be resisted as long as genuine professionalism is opposed to them. To be sure there is a hazard in that exempting a job from civil service, and opening it to quality judgment, also opens it to political appointment, and it is for this reason that the political commitment to professionalism must be deep and enduring.

As for appointments to the governing board, the executive (who normally makes them, with legislative approval) must understand that their quality is one of the ornaments, or even more visible defects, of his administration. Appointments to a board are a tangible expression of policy, and an opportunity of assurance to the executive's constituency that he has its interests at heart. If he wishes to make the agency's constituency his own, this is his best chance to do so. His task, simply put, is to find appointees who are acceptable both to the legislative arm and to the agency's constituency. He should use the agency staff to inform him of how given individuals stand in the constituency's estimation, and if he is wise he will now and then defer to the staff's opinion, since doing so will gain him credit at little cost.

The importance of the governing board varies directly with its perception of that importance, and it is for this reason that the method of selecting members takes on such weight. In most instances they will be defined as citizens distinguished for their achievement or interest in the area with which the agency is concerned, and they must indeed perceive themselves as distinguished, inasmuch as their duty is to take ultimate responsibility for the agency's actions. They must be prepared to stand as a barrier between the agency's decision-making process and all forms of interference or attack. If they are not prepared to do so, everything else is in danger of coming unstuck. Matters of dignity and self-esteem, which might otherwise seem trivial, become meaningful in this context, since the routine work of governing boards can be defined as whatever they consider necessary to verify to their own satisfaction that the decision-making process is one they can properly defend. A board member who takes everything on trust and another who wants to scrutinize every decision are thus presumptively of equal value.

A shortage of good trustees is universal in the nonprofit sector, but in searching for them the public funding agency has one advantage in that wealth or a gift for fund raising are not among the requirements, with the money coming from elsewhere. Other qualifications are very similar, foremost among them the ability – more rare than one might imagine – to think and act comfortably in the area where policy and specific decisions meet. Intelligent trusteeship calls for an extraordinarily delicate combination of forcefulness and restraint; it is the ability to direct without meddling, to hold a firm but easy hand on the rein. Of their nature boards are schizophrenic, and oscillate between intense concentration on individual items and general complaints about not having enough time for high-level policy. Acceptance of the pull-and-tug between these polar opposites is fundamental to effective performance as a board member.

A signal disadvantage of public-agency boards is that their members are of necessity political appointees. To suppose that an executive, under the usual requirement of legislative concurrence, will make appointments to a presumably prestigious board without taking political considerations into account is unrealistic. Since one of the functions of the board is to inspire legislative confidence and approval for its appropriation, for it to be wholly unpolitical might just as well mean being wholly ineffective. At a very minimum the board will be "political" vis-à-vis the internal politics of its constituency. But every effort must nonetheless be made to insure that the board as such does not become a partisan body. Once again the nonprofit sector has an advantage it can exploit in the candidates for appointment who can be found among the impeccably distinguished, but politically neutral, members of the professional guild in the agency's field. The presence of artists on a board concerned with the arts is no guarantee of eliminating politics, but they do serve to anchor it in some other reality – that is, the reality with which the board is presuming to deal. Another advantage lies in the fact that local communities frequently have so few citizens who take an active interest in politics and the nonprofit sector that they turn out, in effect, to be the same people; they will already have made the accommodation which board membership asks of them. Put another way, there are at least two sources of independent-minded persons which can be relied on to continue producing them.

Once appointed, however, board members must rise above the reasons for their appointment. They must be representative, but they must not act in the capacity of representatives. The board overall will inevitably be a "balanced" ticket, in the sense that it must demonstrate to the casual observer an earnest effort to take account of the major elements in the agency's constituency and the community at large. But board members once in office and in action must be willing to set aside, or even disown, their parochial origins in order to speak and vote on behalf of a more largely defined public interest, which they alone now embody. Boards of public funding agencies are in fact one of the few places where the public interest as purely defined can take on body and substance, and routinely become a serious factor in decision making.

Since they were chosen because they were "interested" citizens in the first place, board members will continually be open to criticism for conflict of interest. This is a chronic affliction and will recur in connection with the agency staff and their professional advisers; it is in the nature of the system itself. Complete impartiality can be purchased only at the price of ignorance. Part of the difficulty is that conflict of interest, as an idea, arises from the law, with its adversary procedures, where conflict is a meaningful condition. Governmental standards of ethical conduct derived from the law, in order to be workable, are necessarily so vague that the entire subject becomes a cloudy one, in which appearance matters almost as much as reality. To seem to have a conflict is as bad as having one. Under the circumstances it is impossible to avoid having board members who are connected one way or another with organizations the agency will wish to fund. The only solution is to acknowledge this openly and invoke the usual "foundation" rule of removing the individual from the discussion of any organization with which he is associated. In the long run, board members can disarm such criticism only by scrupulous restraint on their own part and demonstrably fair and judicious performance on the part of the board. The greater the degree to which the board learns to work together as a unit, the greater its immunity to conflict-of-interest charges and the greater the authority with which it will speak. This power cannot be conferred; it has to be achieved.

The relationship of the board to the agency staff will be the problematical but necessary one which, unto eternity, all organizations have had with their boards of directors. It is never perfect, and what it chiefly calls for is a mutual acceptance of the imperfect roles to be played. The staff serves the board, but it must do more than merely implement; it must serve thoughtfully. Agency staff members should have, first of all, a psychological or career commitment not to government but to the subject matter with which the agency deals. Insofar as possible they should be professionals from the field involved, especially in the middle range of staff where the field covered by one person may narrow to a specific discipline. A career background in government alone is unsuitable, if only because it may provoke accusations of bureaucratic thinking even where they are not deserved. The situation is classically suited to what has been called the "in-and-outer" in government, the person who consciously constructs a career pattern on the assumption that public service will from time to time form a logical part of it.

The virtue of being a professional is being able to deal with other professionals as an equal, with the object of establishing trust. For a major portion of the agency's staff time will be spent dealing with the constituency, and most directly with the constituency's professional guild. People who permit themselves to be assessed, as any supplicant for funds must do, wish to be assured that they are being assessed by equals, or else the relationship between the two will fester. While it is probably asking too much for agency staff members to equal their fellow professionals in performance, they can at least be equal to them in their commitment to professionalism. At the same time they should not be professionals *manqués*, trying to realize frustrated ambitions by over-influencing or over-directing the organizations which they fund. Professionalism has a concealed double edge, in that the more "professional" the agency staff becomes, the more harsh and incisive may be its judgments, and the more unpalatable to those being judged.

For the public funding agency, unlike most of government, is still expected to respond to its public personally and politely. Where these high expectations come from, or whether they are justified, is unimportant alongside the fact that they exist; they are a compliment to the agency, by implication, but they present it with certain staffing requirements which are not easy to satisfy. For agency staff members a saint-like patience and equanimity are useful attributes, if not essential ones, in view of the prevalent belief among some applicants that the best way to get money out of government is to be obnoxious. They should also have, in full, immunity to the ego-inflation which sometimes accompanies presumed control over large sums of money. And they must, lastly, have it fixed firmly in their heads that asking for money is a demeaning experience for most people, and that the state of mind of the supplicant can easily be abused and abraded, however unintentionally, unless heroic doses of tact and sympathy are applied. The vocation of public philanthropy has as its first commandment, put yourself in the other person's place, and stay there.

The work of the agency staff is mainly analytical; in close contact with the organizations to be funded, agency staff members develop the information on which evaluative judgments of the organization can be based, and they refine those judgments into preliminary form which may well, if unchallenged during further review, become the final form. It is very difficult for them not to conclude that they are in fact making the final judgments, since this is so often the case, and it is to remind them of their coordinate and cooperative position that advisory panels and the agency board exist. The staff's prerogative is to make the first move. They must be able to arrive at thoughtful perceptions based on a realistic concept of need – that is, to reach a sharp and dispassionate overview of an organization's performance measured against its potential, its audience, its socio-economic context, its position in the heirarchy of its kind, and so forth. In the present generation most practitioners have acquired these skills through on-the-job training, since formal academic programs in nonprofit administration are few and recent in origin. There are benefits in this pragmatic approach; experience which includes site visits and face-to-face contact with the organizations continues to be not only the best training but the best practice.

In the course of time the staff will become a principal repository of knowledge about the area with which the agency is concerned. Its central position, combined with its own information-gathering imperatives, give it a unique command over its subject matter. In some instances it may be able to spare the resources for direct commissioning of research, and its operative needs for research – both in long-range planning and in making its case politically – are greater than those of private foundations. But most of its empirical expertise is unlikely to be formalized and will more often simply accumulate in the minds of staff members, who in any event are too busy to do anything else with it. Pragmatism does have limits, and the nonprofit sector is notorious for its lack of conceptual thinking. The entrance of the arts into the arena of public policy, to the extent that it has even been noticed, has virtually been unaccompanied by thoughtful discussion and debate as to what this development implies. How many symphony orchestras does a given area need in proportion to what it can afford? Can an art form become economically obsolete and nonetheless be worth saving artificially? These and others like them are questions that agency staffs must confront daily, and for which they must seek workable solutions without whatever reinforcement a theoretical framework might give them. In order to function at its full capability, therefore, the agency staff must become something of a seminar on the subject of its own operation. It must be a thinking entity; it must originate the ideas which fuel and energize its board.

Professional panels serve a dual function. Primarily they are the recognized arbiters on questions of quality and professionalism. They take the information provided by the agency staff and subject it to scrutiny of their own viewpoint as active practitioners; they come in directly from the field, with some of its dirt still under their fingernails. Their perspective is invaluable and their judgments have implicit authority. But they are also a highly useful information link between the agency and the constituency, since it is from the constituency's professional guild that they will normally be drawn. It is their opinion of the agency – its practices and personnel – which the constituency is most likely to trust.

The rulings of the professional panels have a salutary and astringent effect. They serve the essential purpose of exorcizing any potential for tyranny on the part of the agency staff, with whom they can be expected to disagree, provided the governing board is informed of the disagreement and prepared to overrule both, if necessary. Panels will sometimes feel resentment at being overruled; they come to think of themselves as the voice of the only abstract and disinterested value system in an otherwise skewed and distorted process. They must therefore be persuaded, contrary to their instincts, that the validity and plausibility of the total systems would be jeopardized if their decisions alone were invariably to prevail. Panels have a higher degree of epidermoid irritability than any other component of the system, since they are self-defined as the most sensitive and vulnerable. When their decisions are reversed, they in their turn require to be assured that this was not for whimsical or arbitrary reasons, since a lack of confidence on their part in the total process would quickly communicate itself to the constituency at large.

Appointments to the panel can safely be made by the agency director on recommendation of his staff, but membership must be rotated (three-year terms with a third of the members being replaced each year is normal and workable). Rotation is essential to prevent the formation of cliques or the predominance of a limited viewpoint, but it is also more useful than might appear in maximizing the number of persons who have served on panels at one time or another, since doing so is a highly educational experience in the difficulties and complexities of funding decisions, and serves to educate the constituency. The more sophisticated the panels, the more sophisticated the process. Panels have on occasion been anonymous, but increasingly the custom is to let the membership be known, at the very least after the funding cycle has been completed. In the name of participatory democracy carried to excess, experiments have been undertaken with panels whose sessions are open to the public, though this example seems unwise to follow generally, since it so seriously reduces the level of candor to be found in the most productive panel discussions.

Most panels can be trusted to write their own rules and frame their own procedures, though in the course of things they will be dependent on the review and analysis conducted by the agency staff and its independent auditors. Above all the panel must safeguard its own integrity. If the pinciple of confidentiality is adopted it should be strictly enforced, by sanctions which may have to include dismissal from the panel. Situations implying conflict of interest are endemic to panels, as they are to governing boards, and must be handled in the same way – by recognizing the reality and removing the individual from the decision. Where panels have a great and often either unused or misused opportunity is in the gray area which borders on overall agency policy, where a panel will be peculiarly sensitive to changes in climate or priority which take place from one year to the next within its area of special competence. Responsibility for any eventual change in agency priorities rests with its governing board, but from the panels can come fresh and authentic advice which is well worth listening to. The panels are an intense focal point where the needs of the constituency and of the political matrix converge.

The constituency in its turn is composed of three layers, roughly in the form of a pyramid. The top, and smallest, layer consists of the professional guild, or those people who make their careers in the area of the agency's interest or are directly employed by the organizations the agency supports (I include in this group the administrators and trustees of such organizations, since in most practical matters their interests are the same). The second, and much larger, group is made up of those who use or are affected by the services the organizations provide, which for convenience can be called the audience. The third, and larger still, includes the entire portion of the population that can be shown to hold a favorable view of the agency's purposes, even though they do not avail themselves directly of the organizations or their services. The total of the three groups forms what has been described as a "favorably inclined coalition," and if its size is larger than half of the adult population, then a favorable situation for public funding can be said to exist.

For the constituency to make its influence felt it must be organized, and here the conventional structures of citizens' groups, committees, and the like have generally proved to be workable. They are familiar and well-understood devices and, though many in the nonprofit sector are unaccustomed to the amount of work and group cohesion necessary to secure public funds, they have usually been quick to learn. The citizens' group will of course exercise itself in the normal activities of generating publicity, interviewing legislators, mounting letter and telegram campaigns, and so on, for all of which it is well suited. For the more precise and functional side of working with government – for example, daily contact with the legislative process – it is less well suited, and here it must enter into an intimate but tactful partnership with the agency staff.

Since the agency itself will most likely be forbidden by law to engage in lobbying on its own behalf, great care must be given to avoid crossing the invisible but very real line which separates what is technically illegal but permissible from what is not only illegal but definitely not permissible. The restriction on lobbying is one of the classic contrasts between reality and a necessary fiction in American life, where any agency that does not keep an eye on its own interests does not survive for long and yet there must be limits put on the interventions which can be allowed. Lobbying is a full-time job, since very close attention must be paid to the day-to-day changes in mood and the pattern of events, and the reaction must be instantaneous. In the nonprofit sector, however, this necessity is not always recognized, both because there has been so little experience of it and because the expense seems excessive, with the result that much of the burden falls back on the agency. Perhaps the only answer is to say that with prudence and good sense a reasonable subdivision of labor can be found between the agency and its citizens' group.

The prime failing of citizens' groups is that they can all too easily fall into the hands of those who have the time and resources to give them. There is no guarantee of their being representative, no matter how vigorous an effort is made to sign up names from all corners of the constituency. The letterhead may look impressive, but the actual direction may still reside with a small minority. Few parts of the United States, moreover, are immune to the metropolis-hinterland syndrome, which is a built-in source of potential conflict between one part of the constituency and another. In the metropolis there is a conviction, often well justified, that there only does quality reside and are standards maintained. In the hinterland there is a perennial sense of grievance waiting only to be detonated by some real or imagined slight. Unless the conflicts between them are contained, they can result in fatal misadventures, the worst of all occurring when one part of the constituency begins to lobby directly with the executive and the legislative on its own behalf. When the constituency becomes *internally* politicized it is in grave danger of fragmenting and of losing that bulky and monolithic authority which originally commended it to political attention.

From the point of view of those being funded there is a great deal to be said for predictability. It requires a very strong commitment on the side of the process of value judgment to enjoy the consequences of that judgment when applied to oneself. Many cultural organizations would prefer, as in some states (North Carolina, for example) they are, to be line items in the state budget in their own right. In other states some have so succeeded in imposing their will as to achieve similiar results by different means; in Missouri about 70 percent of the state arts council budget goes to two symphony orchestras. Yet the defects in such solutions seem to me far to outweigh their few advantages. One argument against direct subsidy, and a strong one, has always been that it perpetuates an organization without regard to variations in the quality of its management or delivery of service, where the public funding agency can at least point to such variations when they occur. Moreover, when increased funds are needed, it is far easier to mobilize public opinion behind a broadly defined field of endeavor than behind a handful of institutions, usually large ones, which have boards composed of people with private means. Most important of all, to structure public funding so as to favor a limited group of recipients belies the presumption of social purpose for which the funding was undertaken; to do so cannot be morally defended nor, over the long haul, politically validated and incorporated into an acceptable mix of governmental obligations.

There is no need to deny, even now, that the system of which the public funding agency forms the centerpiece is subject to a variety of stresses and strains. The system is dynamic; its elements are in active response to one another. At times it seems almost as though feelings of dissatisfaction were an obligatory accompaniment to its operation. Perhaps this is because public philanthropy is not very convincing as philanthropy. It does not have the connotations and overtones of a gift but, rather, tends to be thought of as a matter of due, almost of right. Since tax money derives from the people, there appears to be nothing illogical about the people's getting it back. The organizations that receive public funding eventually come to think of it as their money – as, in a very real sense, it is.

All of which increases the pressure to eliminate value judgment from the process and replace it by formulas. Those who desire to do this can argue, quite plausibly, that the system as described in this paper is inherently unstable; and their very argument, to be sure, increases that instability. In the field of arts funding a number of proposals have been made or adopted which, in pursuit of stability, have or would have exactly the opposite effect. In California a proposal has been given serious consideration by the legislature to replace the direct funding organizations by "user-oriented" funding, in which they would be paid only for the services requested of them, in the form of tours, programs in the schools, and the like. The measure of quality would be sacrificed in favor of what would be, in effect, a popularity contest; and the organizations themselves would be forced into divisive and destructive competition. In New York the legislature has imposed on the state arts council a requirement that at least half of its total grants funds go to so-called "primary" organizations, and that "arts services" be distributed throughout the state on a basis of seventy-five cents *per capita* per county, while at the same time the mandate for quality judgment was not altered. The attempt to comply with this bizarre piece of legislation – that is, to make over fourteen hundred funding decisions on the basis of merit and non-merit simultaneously – naturally proved to be an administrative nightmare.

What happened in New York State is an archetypical example of the internal politicization of the constituency and its unhappy consequences. Pressure for the 50 percent allocation to "primary" organizations came initially from the major institutions, many of them located in New York City, which felt they were being unfairly treated and so informed the governor. He adopted their proposal in his executive budget, only to have it thrown out by the legislature, which recognized it for the special-interest measure it was. The following year, however, pressure for the *per capita* provision came from the upstate legislators, who had been persuaded that upstate institutions were being unfairly discriminated against in favor of New York City. The combination of the two pressures constituted a tradeoff and was therefore acceptable, if not attractive, politically. Once the game had begun, and people could see it being played, open season was declared on the arts council budget. The year after, the third year, amounts in the hundreds of thousands of dollars were sequestered from the council by the legislature for specific purposes, in one case for a "bicentennial barge" to ply the waterways of the state during 1976, in another for the operating expenses of Artpark, a performing-arts facility owned by the state and operated by the Department of Parks and Recreation. Whether this process of nibbling to death can now be halted or reversed remains, at present writing, an open question.

The pressures for routine and regularization also increase in proportion to the amount of funds made available, not for named programs but for basic support. The trend in this direction has been without question the most significant development in government funding for the arts in the United States in recent years. Looking back, it is easy enough now to see that the turning point came in 1970, when in January of that year the council of the National Endowment for the Arts voted to drop a previous restriction limiting its funding to the "new and innovative," and agreed to consider the "on-going or improved," a euphemism for day-to-day operations. That same year the budget of the New York State Council on the Arts was increased from $2.5 million to $20.5 million (an amount then larger than the federal appropriation for the entire country), in an effort to save from imminent collapse the several hundred cultural institutions concentrated in New York State. Overnight the state funding became vital to their existence. It has continued (with fluctuations) and now stands at $34.1 million. In 1974, for the first time, the New York State Legislature permitted the words "basic support" to appear in the appropriation act, and the council was able to allocate funds consciously and openly for that purpose. In 1975, for the first time, the National Endowment made a major grant ($1 million, over two years, to the Metropolitan Opera) without designation as to purpose, for basic support.

Whatever else one says of this state of affairs, it is certainly in sharp contrast to the condition hitherto faced by private philanthropy. Never before had there been such a widespread and legitimate expectation of sustained funding from a source to which public pressure could be applied if the funds were not forthcoming. Many thoughtful custodians of the private purse had wisely feared the arrival of this day, when the leverage characteristic of private giving would be imperiled because decisions were no longer free and judicious. The reluctance of foundations and individual donors to become involved in ongoing support had all along a solid basis in psychological and economic fact; it is dangerous terrain to enter. But it can no longer be avoided; the crisis in the nonprofit sector is too severe. The road to a long-term balanced pattern of support leads through a partnership in which government, private donors, and (someday, with great good fortune) business corporations will play interrelated roles. It would not be improper to expect that a good portion of the sustaining role might be borne by government, should the nature and limitations of that obligation ever be carefully enough defined. Experience to date has indicated that this can be done, but only if the equilibrium of forces implied by the model and type-case system of interlocked elements is preserved.

I trust this account has made clear how closely the five components of the system do interconnect. A network of structural and functional relationships ties them together; countless filaments of working needs and daily contacts weave back and forth between them. It should also be clear that the components have the capability of correcting one another; each is watched and can potentially be restrained by one or more of the others. But it is only a capability. Though the interests necessary to a balanced performance are all represented, they will be effective only if someone asserts them. This is to say no more than that the public funding agency, as it has thus far emerged, is a live institution, not yet permanently frozen into formulas and rigidities. If it works, at this stage in its development, it works because people make it work.

PRIVATE FOUNDATIONS AND THE 1969 TAX REFORM ACT

Chairman and Staff, Council on Foundations, Inc.

Introduction

This report seeks to present a succinct, factual account of the role and significance of America's philanthropic foundations. Particular attention is directed to the effects of the Tax Reform Act of 1969 on these organizations. Two sets of recommendations are offered: one involves action by foundations themselves and the other involves government policy and changes in the law.

The term "foundation" is not precise, even apart from uses having nothing to do with philanthropy. We are mainly concerned here with those institutions that under the 1969 Tax Reform Act are classed as "private foundations" as distinct from other charitable organizations. This distinction is based not on purposes which must in all cases conform to the public interest,[1] but rests primarily on the extent to which a single donor, or family, or company has provided an organization's basic financial support. Moreover, under current law, private foundations are defined only by exclusion. They are the charitable organizations remaining after various groups – churches, schools, hospitals, governmental units, publicly supported organizations and their affiliates – have been filtered out. We shall also, therefore, rely on F. Emerson Andrews' more direct and commonly accepted definition – namely, "a nongovernmental, nonprofit organization, with funds and program managed by its own trustees or directors, and established to maintain or aid social, educational, charitable, religious, or other activities serving the common welfare."[2]

The Council on Foundations, whose officers have conducted this study and prepared this report, is an association of some 775 foundations, mainly of the endowed and grant-making types. Its members are situated in all parts of the United States, include both small and large foundations, and currently administer over 65 percent of all estimated foundation assets in the United States. The council functions under an elected board of directors broadly representative of the foundation field but also including nine public members. The council's chief purpose is to advance effective and responsible practice throughout the foundation field.

I

GENERAL BACKGROUND AND RATIONALE

Brief History

The origins of charitable foundations extend far back beyond the Christian era, and at least partial analogues are to be found in many civilizations besides our own. The philanthropic impulse, which is their ultimate source, seems to be both age-old and world-wide. In the Anglo-Saxon world the status of foundations and other charitable endowments as legal entities enjoying certain privileges and a standing distinct from that of their donors is anchored in the Common Law. As reflected in both state and federal statutes, it continues to have that underpinning in the United States, even as it also does in England.[3]

The emergence of the modern American foundation as an instrument for searching and systematic grant making dates from the post-Civil War period. Major foundations were established coincident with the birth and growth of great fortunes in late nineteenth and early twentieth century America and well before any significant tax advantages for their donors were involved.[4] Simultaneously, under the leadership of men like Andrew Carnegie and John D. Rockefeller, foundation philanthropy came increasingly to seek to identify and deal with the causes, as distinct from the symptoms, of human misery and deprivation; it sought, that is, t[illegible] the weapons of systematic investigation, experimentation, and research to [illegible] attack on many different kinds of human need.[5]

Until World War II the number of known endowed, grant-making foundations in the United States was not large. In the period 1940 to 1969, however, a proliferation occurred under a combination of favorable economic conditions and strong tax incentives to charitable giving. Thus of the 5,454 foundations listed in edition 4 of the *Foundation Directory* (1971), 90 percent were set up after 1940, but that explosive growth was primarily in foundations that are small in size.[6] Among foundations with assets of over $10 million as of 1968-69, 9 percent were established before 1920 and a total of 38 percent before 1940, while of those with under $1 million in assets only 1 percent were set up before 1920 and only 4 percent before 1940. (See Chart A-1 and Table A-1, Appendix A.)

With the proliferation of foundations, there unfortunately came abuses. Investigations in the 1960s revealed that some persons had set up foundations more for personal advantage than for public benefit.[7] Some, it was found, were benefiting friends and relatives; others were being used to maintain control of companies; some were hoarding assets and making almost no return to charity; and in a few damaging instances it appeared that foundation grants had been made to advance partisan political interests.

Such evidence as is available appears to indicate that these abuses and indiscretions were not widespread, and most of them could have been eliminated by vigorous enforcement of existing law. Nevertheless, they were sufficient in the tax reform climate of the late 1960s to cloud the reputation of the foundation field generally and to trigger the passage of stringent legislation affecting all private foundations. This legislation and its effects are the principal subject of Chapter III of this report.

Foundations had from time to time been under attack from various quarters and for various conflicting reasons long before the 1960s.[8] Nor were the abuses and indiscretions cited above by any means the sole grounds of the congressional attack experienced by foundations in 1969. There was an accumulation of other influences and pressures.

From a "conservative" perspective, foundations were too much engaged in social change – in the support of social science research, for example, and voter registration among minority groups. From a "liberal" perspective, conversely, foundations remained on the whole too wedded to the *status quo*; both their will and their efficacy in contributing to needed social changes were questioned.

Simultaneously, populist suspicions of concentrations of wealth "extracted at the expense of workingmen and consumers" were rampant, coupled with similar suspicions of intellectuals and experts. Rekindled in significant degree by Governor George Wallace, these hostilities were reflected by influential members of Congress from both major political parties in the hearings and debates leading up to the passage of the 1969 Tax Reform Act.

Meanwhile, the needs and aspirations of a growing America for more and better education, health care, and other social services had combined to generate large federal spending programs in those areas and to put enormous pressures on the tax system. Would it not be better, some asked, for government agencies to take over these services entirely? And in these circumstances, economic theorists and legislators alike were inevitably led to look to close off tax deductions, exemptions, and credits where they could. As it proved, those tax preferences enjoyed by foundations and donors to foundations were the most vulnerable. More than any others, they lacked organized constituencies.

A further potent factor was a theory of taxation that gained marked new influence in the 1960s. According to this theory, all authorized exemptions and deductions, including those for giving to charitable purposes, were held to be government expenditures – or, in effect, to represent government money. Charitable organizations were thus more easily thought to be subject to governmental determinations and controls.

In 1969 these influences, in various combinations, prompted many members of Congress from both parties to question the tax incentives and the freedom of decision about the disposition of wealth enjoyed previously by those who had wished to establish foundations. Alongside the instances of abuse, these mingled doubts and pressures served to bring about the elaborate regulations and stringent sanctions under which their trustees and managers must now conduct the affairs of private foundations.

Rationale

Before moving on to the present dimensions of the foundation field and apparent effects of the 1969 legislation, it is important to recognize something too often overlooked by foundations themselves. In the 1969 Tax Reform Act, the Congress gave renewed legislative endorsement to foundations as significant social instruments entitled to substantial tax privileges, even if not to all those previously enjoyed. It is also worth remembering that when the Senate considered a proposal to impose a 40-year limit on the lives of private foundations it rejected the proposal by a very large majority.

The continuation of tax benefits for foundations undoubtedly occurred for reasons that reach below – or, at least, have proved to date sufficient to countervail – the sorts of doubt and criticism just discussed. Basically the reasons lay in our country's long traditions of voluntarism and pluralism and in a persistent sense of the worth and vitality of these traditions in the minds of most Americans.

The latter is strongly reflected, for example, in a representative sample of opinion undertaken by The Gallup Organization in 1972.[9] This survey revealed that 71 percent of the American people believe that private giving to health agencies, colleges, and agencies such as the United Way is as important or more important today than in the past. A majority, 52 percent, think such contributions are more important. Somewhat surprisingly perhaps, even higher proportions of those under the age of 30 expressed affirmative views. As for foundations specifically, 64 percent of those polled regarded them favorably, and only 10 percent expressed unfavorable attitudes. When the main new regulations governing private foundations were explained, 73 percent thought them to be sufficient or excessive; only 6 percent thought additional restrictions to be desirable.

Indeed, foundations can flourish only in societies in which personal freedom and responsibility are valued and where private initiatives for the public good are deemed to be important, even intrinsic, social assets. At the root, the case for them is that for private philanthropy in general. As expressed by Dr. Landrum R. Bolling, the justification of foundations and philanthropy alike rests fundamentally on three beliefs:

1. The importance of encouraging voluntarism in the satisfying of social needs, of maintaining the human, empathetic feeling of personal responsibility in the face of social needs.

2. The wisdom of decentralization, down to the local grass roots, of some portion of the tasks of providing our educational, cultural, charitable services.

3. The usefulness of having available some alternatives to many Government services, even when those Government services may be universally accepted as the norm.[10]

Within philanthropy thus broadly conceived, foundations have the particular characteristic of serving as sources of available capital for the private philanthropic service sector of our society in all its range and variety. They thus help make possible many useful public services that would in most cases otherwise have to be provided by tax monies. They offer "the other door on which to knock," without which many volunteer activities would not be initiated and others could not be continued. They are there to respond to both new ideas and shifting social needs with a freedom and flexibility that is not common to or easy for government agencies. Finally, as centers of independent thought and judgment in their own right, they help support freedom of thought, experimentation, and honest criticism directed at pressing needs of the society, including even the scrutiny and evaluation of governmental programs and policies.

II

DIMENSIONS OF THE FOUNDATION FIELD AND PROGRAM TRENDS

Types of Foundations

In identifying a philanthropic foundation an organization's name is often of little value.[11] And even among the genuine articles, there are enormous differences in asset size, scope of interest, and mode of operations.

According to IRS classifications, there were about 30,000 "private foundations" in the United States as of September 30, 1974.[12] Of these, about 1,100 were operating foundations, that is, they were primarily involved in conducting programs with their own personnel or facilities, rather than by making grants to other institutions or agencies.[13] Almost 29,000 were classed as "private non-operating foundations." This number includes, however, many institutions which are not primarily grant-makers but are also not classified by the IRS as operating foundations.[14] Based on examination of the 1971 and 1972 IRS files, The Foundation Center estimates that there are currently approximately 25,000 private foundations with discretionary grant-making powers. This estimate will be subject to revision as the IRS applies its administrative regulations to a variety of nonprofit organizations.

Reference must be made at least in passing to another very important type of grant-making foundation. This is the community foundation or trust, of which there are some 250. Collectively they administer over $1 billion in assets. A few – The Cleveland Foundation, New York Community Trust, and Chicago Community Trust – each hold assets at or above the $100 million level. Some 20 maintain endowments of more than $10 million, but most are far smaller. Community foundations are characterized by multiple sources of funding, boards of directors selected to reflect public interests and concerns of their communities, and a local or regional focus in their giving. Because of their several public characteristics, community foundations are classified as "public charities" under the 1969 act (along with churches, colleges and universities, hospitals, and other "publicly supported" organizations and affiliates of these groups) and accordingly are subject to fewer and different regulations than are the private foundations. In part because of their favored tax status, the estimated assets of community foundations grew by 30 percent in 1972 and another 10 percent in 1973.[15] Much of this increase appears to have come from the termination of private foundations.[16]

Since a separate report on community foundations has been submitted to the Filer Commission,[17] this report will not be concerned with them as a separate type. But it should be noted that in the choosing of charitable objectives, processing of applications, and making of grants, the work of the community foundation and the private foundation is often indistinguishable. For instance, many of the private foundations confine their giving to the needs of their own regions and localities.

Among the private non-operating foundations a somewhat special class is formed by those established by corporations as a means of instituting and carrying out systematic programs of charitable giving. They are estimated by The Foundation Center and The Conference Board to number about 1,500, of which only about 273 have assets of over $1 million. In the most recent (1973) Conference Board *Biennial Survey of Company Contributions*, 58 percent of total corporate giving reported for 1972 was accounted for by company foundations. Frequently, corporate giving through the instrument of a foundation or otherwise tends to relate to the needs of communities where the company plants and employees are located. Few company foundations have large endowments; most receive and distribute annual contributions from the parent company. Again, however, the well-run company foundation faces much the same problems and works in much the same ways in determining priorities, in assessing alternatives, and in making the choices that it hopes will do the most good, as does any other well-run grant-making foundation. But since company foundations, too, are the subject of a separate report to the Commission, in connection with other forms of company contributions, they will not receive further treatment here.[18]

Assets and Their Distribution

The total holdings of the private grant-making foundations can only be estimated. The nearly 25,000 foundations on record in The Foundation Center had assets with a market value totalling about $31.5 billion in 1971 and early 1972, and these numbers almost certainly include most if not all foundations with assets over $1 million (Table A-5, Appendix A). It is probable that at the end of 1974 the assets of these 25,000 foundations were down at least 25 percent to 30 percent in market value as against The Foundation Center's figure.[19]

The Foundation Center estimates that only about 2,500 grant-making foundations have assets of over $1 million and that overall the distribution of assets to numbers of foundations is approximately as follows:

Asset Size	*Number of Foundations*
Under $1 million	22,400
$1 - $5 million	1,699
$5 - $10 million	356
$10 - $25 million	265
$25 - $100 million	146
$100 million and up	38

Of the 22,421 foundations in The Foundation Center's databank for fiscal year 1971 with assets under $1 million, more than half had assets of less than $50,000, but many of these were clearly passing through annual contributions from donors and others were apparently being phased out, as the recorded grants of this group for the year totalled $144 million while their total assets were only $176 million (Table A-2, Appendix A). Average assets of foundations holding assets under $1 million were $115,936. And this is the vast majority of the field.

Tables A-3, A-4, A-5 (Appendix A) show the geographic distribution in fiscal year 1971 of foundations with assets under $1 million, with assets over $1 million, and a composite of these two records.[20] Notable are the concentrations of both numbers and assets in the industrial regions of the Middle Atlantic states and the East North Central states, but with very substantial representations also in the South Atlantic, West South Central (especially Texas), Pacific, West North Central, and New England regions.

A separate study of the geographic distribution of the giving of the 50 largest foundations in 1971-72 and also of all foundation grants on record in The Foundation Center for 1972 showed it to be in both cases widely spread through all parts of the country. But as might be expected, it was considerably heavier to institutions and agencies located in the nation's most heavily populated centers than to those in less industrialized areas.[21] Even so, it is clearly no longer proper – if it ever was – to think of the philanthropic foundations as mainly creations and instruments of some "Northeastern Establishment." While a few of the oldest, largest, and most highly organized of the foundations continue to be located on the eastern seaboard, there are today many other foundations engaged in substantial grant making throughout the United States.

Distribution and Trends by Fields

The spread of foundation giving by broad fields of activity in each of the years 1961 to 1973, as recorded by The Foundation Center, is presented in Tables A-6 to A-13 (Appendix A). For the 13 years, the distribution has been as follows:

Areas of Giving	*Grants* (dollars in millions)	*Percent of Total*
Education	$2,631	32%
Health	1,265	15
International Activities	1,117	14
Welfare	1,084	13
Sciences	1,036	13
Humanities (including Arts)	710	9
Religion	368	4

Unfortunately, the nature of the available data and the breadth of the fields into which they have been classified make it impossible to detect more than the most general trends from these records. Education has consistently been the largest beneficiary of foundation support. Religion has consistently been the field least favored by foundations, and by a considerable proportion, while year after year it remains the largest recipient of the giving of individuals.[22] Since about 1968 there has been somewhat of a decline in foundation support for certain international activities, following an extended post-World War II period during which several of the large foundations were expending very substantial sums annually to help build up the foreign area training and research capabilities of America's universities as well as to complement government programs of assistance to developing countries. Otherwise, the relative ranking of fields has remained quite constant over the 13 years.

Within education, higher education appears to have benefited in considerably larger amounts than other areas (Table A-7, Appendix A); to cite the estimates of *Giving USA* again, over the six-year period 1968/69 - 1973/74 foundations have regularly contributed between 22.5 percent and 25.9 percent of all private giving to colleges and universities.[23] Although support for the arts and humanities is a small segment of total foundation support, *Giving USA* estimates that foundations accounted for some 15 percent of total contributions to this field in 1974.[24]

Matters of Scale and Impact

Of all private giving in the United States – some $25.15 billion in 1974 – foundation grants amounted to about $2.11 billion, or 8.4 percent.[25]

That percentage surprises many people. They assume foundations are bigger than they are. Those who believe that foundations exercise excessive financial power should compare $2.11 billion dispersed by some 25,000 separate entities with the more than $25 billion dispersed annually by the Department of Health, Education and Welfare over and above Social Security payments. Other perspectives as to foundation power are gained from comparing the 1973 combined volume of $667 billion of business, expressed in sales, of the top 500 industrial corporations with the combined volume of business of all of the foundations, expressed in grants, of $2.11 billion or the $555 billion in assets of those corporations with the same $30 billion of foundation assets. Or consider the country's pension trusts, reported as amounting to $150 billion in book value in 1972. Several considerably exceed in size the assets of The Ford Foundation – which at $2.0 billion at last report were twice as large as the next largest foundations, and many more times larger than the general run. In brief, an important characteristic of the financial resources represented in the foundations is that they are broadly dispersed and available to help respond to the great variety of human needs in their just as varied circumstances. And to our knowledge, there is no private grant-making foundation that feels it has adequate resources to meet the number of interesting and worthy applications it receives.[26]

To a particular college, hospital, or even for a whole community, the assets of a particular foundation may, of course, loom very large indeed – the degree depending most probably on both the relative size of the two parties and the intensity of the former's sense of need. And there have undoubtedly been occasions when foundation "pipers" thus have been able to lead would-be grant recipients into lines of action, or fields of endeavor, that they might not otherwise have chosen.[27] On the other hand, there are needs to be met and new undertakings to be attempted which require very substantial commitments if major results are to be sought. An example is the Rockefeller Foundation's pioneering investment since 1942 of more than $120 million in the agricultural science and technology out of which came the new high-yielding grains for "The Green Revolution." The searching and extensive analysis of American higher education accomplished by the Carnegie Commission on Higher Education, under the chairmanship of Clark Kerr, required some $6 million over a six-year period. And where, one can ask, would the hard pressed symphony orchestras be today in 60 cities of America without the nearly $84 million which The Ford Foundation, working in conjunction with local groups and local leaders, has been able to provide over the past decade for their nurture and strengthening?

None of these three foundations is small by any measure except those of government and big business, and we have not meant to imply otherwise. Furthermore, it is surely the case that they, and the whole legion of smaller foundations as well, would contribute much less than they do if they were entirely passive. Their choices of charitable objectives and of individuals and agencies to work with do have an influence and do make a difference in some degree at least.

In summary, viewed in both the aggregate and the individual case, the significance of foundation assets usually lies less in their magnitude than in such capacities as foundations can develop – usually in concert with recipient agencies – to direct limited assets toward beneficial results, to accomplish things that otherwise might not be accomplished or accomplished as well.[28] That is a prime challenge to the endowed foundations: on the one hand, to be more searching, more objective, and have a longer eye to the future than the giving of individuals usually tends to be; on the other hand, to be more flexible, more adaptable to specific situations and to specific institutional potentials, less bureaucratically constrained than governmental appropriations and governmental agencies generally can be.[29]

III

THE 1969 TAX REFORM ACT AND ITS EFFECTS

Summary of Principal Provisions

Some one fifth of the provisions of the Tax Reform Act of 1969 were directed at private foundations. The Internal Revenue Code now distinguishes such foundations from "public charities" in the following ways:

- It imposes a 4 percent tax on the income a foundation derives from investments (Section 4940).

- It strictly regulates dealings between a foundation and those who manage, control, or make large gifts to it. These restrictions also apply to closely related persons – and they apply without regard to whether the foundation is better off as a result of the dealings (Section 4941).

- It requires that non-operating foundations pay out for their charitable purposes each year the greater of net income or a fixed percentage (up to 6 percent and more) of asset value. The Secretary of the Treasury has authority under a formula to change the rate (Section 4942).

- It limits ownership by a foundation in a business to stated percentages of the equity interest (Section 4943).

- It penalizes foundations for purchasing risky investments (Section 4944).

- It bars lobbying, partisan political activity, and targeted voter registration drives by a foundation; and it requires foundations carefully to monitor and account for grants made to individuals and to donees that are not "public charities" (Section 4945).

- It requires foundations to file with the Internal Revenue Service and to publish and make available to the general public annual reports showing assets, earnings, grants, administrative costs, and other information in greater detail than is required of public charities. Private foundations must also file copies of these reports with appropriate state officials (Section 6033).

- The act's provisions are enforced by taxes ranging from 5 percent to 20 percent of the amount involved in a violation, increasing to 100 percent to 200 percent, subject to certain ceilings, for failure to correct. Very aggravated circumstances can result in a tax equal to all of the foundation's assets. Further, foundation managers are personally subject to penalty taxes for "knowingly" violating the self-dealing, jeopardy investment and program restrictions, and reporting requirements (Section 4941-4945, 6652).

- It discourages contributions to private non-operating foundations (as distinguished from operating foundations and public charities) by (1) reducing the income tax deduction a donor can take for gifts of appreciated property to non-operating foundations, (2) limiting such deductions to 20 percent of a person's income for the year (as against 50 percent for gifts to other charities), and (3) foreclosing carry-forwards for gifts in excess of the 20 percent limit (Section 170).

The foregoing short summary cannot adequately reflect the very complex regulatory machinery which the Tax Reform Act imposed on private foundations. Its intricate character is reflected in the facts that the statutory language affecting foundations runs some 60 pages and that the regulations published to date have multiplied this required reading some fivefold. Nevertheless, after an initial period of dismay and confusion, most foundations have managed to learn to live with the new law, and there is an informal consensus that it has in fact removed much of the potential for abuse and improved the responsiveness of the field to public needs and interests. At the same time there are certain less benign consequences of the act to which we will direct attention later.

1974 Council on Foundations Survey

In attempting to assess the impact of the legislation on private foundations, a questionnaire was prepared, pretested, and mailed in March 1974 by the Council on Foundations to its 547 private foundation members and to the 1,700 additional private foundations identified by The Foundation Center as having assets of over $1 million.[30] (The details of this survey and its results are recorded in Appendix B.)

The Council's questionnaire was designed to obtain both objective factual information concerning the impact of the Tax Reform Act in certain areas of foundation operation and subjective impressions and recommendations from the respondents as to their experience under its provisions. These responses are incorporated in the following discussion of the effects of the 1969 act.

The Effects of the Act

The Tax on Investment Income (I.R.C. Section 4940)

The imposition of a 4 percent tax on the net investment income of private foundations is one of the most troublesome features of the 1969 Tax Reform Act, and it drew the most consistent objection (75 percent) from the foundations responding to the council's survey. Many find the tax objectionable in principle and potentially a dangerous precedent for the withdrawal of the tax exemption which has traditionally been extended to charitable organizations on the grounds that they contribute to the public good. More are troubled because the 4 percent tax draws away and consigns to the general revenue funds that otherwise would be going to the support of charitable activities – that is, it reduces the funds available to foundations to distribute to those who are seeking their aid.

The 4 percent tax became effective for private foundation accounting years beginning on or after January 1, 1970. The Internal Revenue Service reports that through the end of the government's 1974 fiscal year (June 30, 1974) the tax had produced $227 million, against auditing and supervisory costs as follows:

Government Fiscal Year Ending	*Revenue From 4% tax*	*IRS Costs– Foundations* (in millions)	*IRS Costs– All Exempt organizations* (in millions)
1968		$ 1.6	$ 7.1
1969		2.1	7.5
1970		3.5	11.0
1971	$24,589,000[a]	8.6	15.4
1972	56,045,000	12.9	19.3
1973	76,617,000	12.3	18.6
1974	69,800,000	13.3	23.0
Total	$227,051,000	$54.3	$101.9

[a] Because of the interrelationship of government's June 30 fiscal year end, the effective date of the tax and return-filing dates for private foundations, this figure probably includes less than half of the revenue yield of the tax for its first full year of operation.

The figures illustrate dramatically how far sums collected by the 4 percent tax have exceeded IRS requirements for auditing and supervision of both foundations and the whole tax exempt field.[31] They also show how much IRS attention to foundations was stepped-up between 1968 and 1972.

Prior to passage of the 1969 act, a number of foundation representatives, including spokesmen for the Council on Foundations, had advocated the institution of an annual filing fee for foundations based on asset size and scaled to cover the costs of improved IRS auditing and supervision. This idea was generally accepted in the Senate, but strong sentiment in the House Ways and Means Committee to make foundations share in paying some of the costs of government precipitated the enactment of the 4 percent tax.[32] In the council's survey, almost as many respondents (72 percent) advocate an auditing fee scaled to IRS costs as wish repeal of the tax (Exhibit 2, Appendix B).

An onerous aspect of the tax for some foundations is the inclusion of realized capital gains in the calculation of "net investment income" against which the tax is currently assessed. Applying the 4 percent excise tax to such gains penalizes foundations that are seriously attempting to diversify and upgrade their portfolios in keeping with the spirit of the act. In addition, applying the tax to capital gains when incurred in anticipation of divestiture requirements can, in effect, amount to forcing incurrence of tax. Moreover, there have even been cases, albeit isolated, where the 4 percent tax on gains was so large that the "distributable amount" – the amount the foundation is required to distribute for charitable purposes for a given year – has been substantially lessened. The gain to the U.S. Treasury is minimal, respondents point out, while the attendant losses to charities are not.

Administrative Costs and Staffing

There appears to be a general consensus in the field that the Tax Reform Act has "cost" the private foundations substantial sums of money through added administrative expenses occasioned by the intricacies of the legislation requiring more man-hours by attorneys, accountants, and professional staff. In addition, the act's heightened emphasis on the responsibilities of foundation managers has produced more adequate staffing for larger foundations and the first full- or part-time professional staff for a number of middle-sized and smaller ones; however, for foundations too small to justify regular staff, the new requirements have presented greater problems and meant sharp increases in their ratios of expenses-to-grants.

These general impressions are borne out by the findings of the study conducted under the auspices of the American Bar Foundation which compared administrative expenses for a sample of foundations for the tax years 1967 and 1970.[33] The council's survey reconfirmed these findings. Comparison of legal and accounting fees for 1968 tax year and the most recent tax year showed an overall increase of over 100 percent (Figure B-3, Appendix B). The respondents, 212 of whom reported no legal or accounting expenses in 1968, on the average attributed 71 percent of this $3,355,000 increase to the requirements of the 1969 act.

Other administrative expenses, while substantially higher for the latest tax year, increased in the survey by a smaller percentage – 66 percent – than those for legal and accounting fees (Figure B-4, Appendix B). The percentage of the increase attributed by the respondents to the TRA was also lower – 46 percent – suggesting that other factors, such as those relating to accountability and responsibility to the public, were at work. Taken together, however, those increases in overall administrative expenses attributed by the respondents to the 1969 act amounted to over $13 million for the most recent tax year, as against 1968.

Several students and critics of the field have commented on the relatively small number of professionals employed by grant-making foundations.[34] Other critics have alleged that administrative overhead is often unreasonably high.[35] while the opposite view is taken by those who feel it is too low.[36] A recent examination of the administrative expenses reported by 56 of the largest foundations concludes that they are, by this measure at least, relatively "efficient" – averaging, in a recent year, 5.4 percent as the percentage of general administrative costs to grants paid and costs directly related to program.[37] The councils's questionnaire asked for *all* administrative expenses other than the 4 percent tax; therefore at 7 percent the average reported by non-operating foundations is understandably higher (Table B-1, Appendix B). Nevertheless, that figure compares favorably with an average of 13 percent for 3,000 New York State charitable organizations recently studied.[38]

With increasing asset value of foundations, grants and administrative costs also rise, but not proportionately. On the average, for foundations with under $50 million in assets, total administrative costs represent 10-12 percent of grants and expenditures. For foundations with assets of $50 million or more, administrative costs represent only 6 percent of grants and expenditures (Table B-2, Appendix B).

The Zurcher-Dustan study gives a rough base-line figure, 1,062, for the staffing of all grant-making foundations in 1970.[39] The council's survey shows how rapidly the respondent foundations have added staff between 1968 and 1973 (Figures B-5, B-6, Appendix B). Executive staff reported by the respondents numbered 972 in their last tax year, having grown 25 percent over the period, while 46 of the 350 respondents added their first executive during the period.[40] A similar 25 percent increase was reported in "other employees" for an addition to total personnel of 814. The Tax Reform Act was cited as the principal reason for the increase in staffing by a clear majority of those reporting increases. More respondents emphasized this as the causative factor in additions to "other staff" than in additions to their executive ranks.

The continuing thinness of staffing is shown by the fact that for the last tax year, 39 percent of the council's respondents listed no executive staff and 56 percent listed no "others" on their payrolls. With 23 percent of the total executive and other staff reported, the Ford and Rockefeller Foundations continue to represent the other end of the spectrum. However, the median size in foundations reporting executive staff was 2, and the median for "others" on payroll was also 2. Thus while the survey shows a considerable growth in numbers during the period covered, foundation staffs are still typically small, and probably too many foundations are still completely unstaffed even when they control substantial assets.

Operating foundations report larger staffs than grant-making foundations in the same size range (Table B-3, B-4, Appendix B). Thus, although no operating foundations have assets comparable to the largest non-operating respondents, the average total staff for all reporting operating foundations was 27, as compared with 12 for non-operating foundations. Similarly, administrative costs of operating foundations were almost twice as high a percentage of grants and other expenditures as those for non-operating foundations – 13.9 percent compared with 6.9 percent.

Reporting to the Public (I.R.C. Section 6033)

As indicated in an earlier section of this paper, foundations and the IRS were criticized in 1969 for the inadequate information available to government and the public concerning foundation activities. The lack of adequate information inevitably added to the aura of suspicion and distrust that clouded the field during the 1969 congressional hearings. One direct result was the Tax Reform Act's requirement of increased reporting, to both the federal government and the governments of states where foundations are domiciled. In addition, the act required that a form of report (990AR) outlining the foundation's finances and programs be made available to the general public at the foundations's place of business and that this availability be announced by a newspaper notice each year.

Foundation compliance with these formal reporting requirements appears generally to have been good, and the forms designed by the IRS to implement the statutory requirements have been workable, though complex. One part of the council's survey sought to determine the extent to which the general public was taking advantage of the required published notices of availability to examine the foundations' 990ARs. As seen in Figure B-7 (Appendix B), this particular channel of information is little used. Seventy-three percent of the foundations responding stated that in 1973 no one had asked to see their report, and more than half of those who had received such requests indicated fewer than 10 inquiries during the year.

This apparent lack of public interest in examining the foundations' 990ARs can be accounted for in part by the increased availability of more complete reports at the libraries maintained by The Foundation Center in most areas of the country. From a nucleus of two complete collections of 990 information in New York and Washington,[41] The Foundation Center has been expanding its network of regional collections to cover 50 additional cities by the end of 1974. Thus a person seeking foundation support for a charitable undertaking can now examine the reports of a number of foundations in his own geographical area by going to a central facility for that area.

In addition to meeting the statutory requirements, increasing numbers of foundations, particularly the larger ones, now publish and distribute annual or biennial reports describing their objectives and activities in some detail (Table B-5, Appendix B). Nevertheless, only 40 percent of the foundations responding to the council's questionnaire have adopted this practice (Exhibit 3, Appendix B).[42]

Other means of publicizing foundation activities which have been increasingly adopted by the field include press releases describing significant grants, occasional newsletters to supplement published annual reports, and furnishing of information to professional journals and other media that have shown a interest in a particular foundation's program. However, one of the easiest methods of providing such information to the public – namely, encouraging grant recipients to publicize grants received – is a practice followed by only about one quarter of the foundations responding to the council's survey.

The Pay-Out Requirement (I.R.C. Section 4942)

One of the findings of the 1965 Treasury report on foundations referred to earlier was that appreciable numbers of foundations, especially some of those holding control stock of single companies, were offering negligible to small returns to charity despite the tax exemption they enjoyed. Congress, in the 1969 act, properly sought to rectify this situation. It required that private non-operating foundations pay out annually the greater of (1) their current net income or (2) a fixed "minimum investment return" (MIR), whichever was higher. The latter rate was set at 6 percent of asset value, with non-operating foundations established before 1969 having a five-year transition period in which to adjust.[43] The Secretary of the Treasury has continuing responsibility to review, and if necessary modify, the MIR on the basis of current money rates and investment yields in relation to the market conditions that prevailed in 1969.

The annual estimates of the American Association of Fund-Raising Counsel indicate, not surprisingly, appreciable rises in the level of foundation giving following the 1969 legislation.[44] The council's survey likewise reveals, as expected, that the grants and program expenditures of the respondent foundations had increased considerably between 1969 and their latest tax year (Figure B-8, Appendix B). However, these increases are not alone attributable to the pay-out requirement; some foundations, for instance, were enlarged by new gifts, and others came into being. It is notable that 31 percent of those in the council's survey attributed their increased distribution over this period to the stiffer requirements of the 1969 act.

The applicable rate of the MIR for most foundations in 1973 was 4-3/8 percent. The average actual pay-out rate, however, for the respondent foundations in their last reported tax year was 5.6 percent, and 47 percent of the sample reported that their adjusted net income exceeded the applicable MIR (Exhibit 4, Appendix B). This suggests that there has been a search for higher current yields on investment portfolios, and responses to a question concerning changes in investment practices confirms this trend among endowed foundations to seek higher yields. Exhibit 4 also shows that 139 of the respondents have revised their practices since 1969 as a result of the 1969 act, and well over half the revisions reported were intended to increase yields. However, in the overall figures it must be recognized that the respondents include company foundations and others which annually receive and distribute fresh contributions; in such cases it has long been common for foundations to distribute annually amounts in excess of what they may have earned on their investments.

Private foundations are required to value their investment assets in order to calculate their minimum investment return. About 20 percent of the council's respondents had problems with the complex valuation procedures (Exhibit 5, Appendix B). Of those reporting difficulties, the largest number had trouble with the valuation of securities for which market prices were not readily available. Other recurring problems relate to the valuation of real estate holdings and the uncertain state of the law with regard to the application of "blockage" rules for large holdings of a single stock. In addition, concern was expressed about the costs of the additional bookkeeping and appraisals required by this part of the statute. On the whole, however, the fact that the large majority of the respondents seem to have been untroubled by valuation problems is encouraging, and it can probably be expected that a number of the reported difficulties will be ironed out as both the IRS and the foundations gain experience with the act.

As to the "total return" concept of investments, which in 1969 was influential in promoting the legislative adoption of the high 6 percent rate as the norm for the required annual pay-out, it is notable that only 8 percent of those reporting changes in investment practices in the council's survey appear to have adopted this investment philosopy. Instead, as indicated, more seem to have been driven to seek higher interest and dividends than to invest in the sort of growth which it was once opined might let "the well-managed foundation" both meet a 6 percent pay-out requirement and "maintain its size in *real* dollars."[45]

In point of fact, the financial experience of the 1950s and 1960s on which those 1969 expectations were based has proved to have represented an extraordinary and relatively brief period of American financial history. The evidence of this is found in experience over many years, not only in the recent sharp downturn of equity markets whereby many foundations instead of experiencing growth have experienced marked declines in asset values over the past year.[46] Various recent studies by distinguished economists, covering most of the past century, show that over extended periods funds invested broadly in American capital markets have yielded no more than 4.5 to 5 percent in *real* total return,[47] not the 6 percent and upwards that experience drawn only from the late 1950s and early 1960s seemed to make predictable when the last Tax Reform Act was passed.

Inflation is of course in no sense an effect of the 1969 act, but its effects intertwine with those of the pay-out rate and hence call for comment here. Even when the country's general rate of inflation was thought likely to increase at no more than a "normal rate" of 2 percent to 4 percent annually, the built-in tendency of the costs of labor-intensive services (such as are involved in most activities that foundations support) to rise at appreciably higher rates raised in some minds serious concerns about an inevitable future attrition of foundation assets. When coupled to the 6 percent pay-out requirement set for 1975 and thereafter, this higher rate of growth in the cost of the kinds of services that foundations normally support portended a progressive decline in the ability of existing foundation assets to maintain their current real levels of support. Given any realistic expectation of foundations' earnings on investments, their future "purchasing power" for these kinds of services could only decline.[48]

At rates of inflation such as are now being experienced in this country, the dimensions and urgency of the problem are much more grave. The values of all charitable endowments are being eroded so rapidly that one can hardly talk about a pay-out rate that will, *within present circumstances,* permit foundations to maintain "their size in real dollars." For the near term, such a rate would have to be inconsequential in most instances; the best one can probably aim at is something that represents substantial current foundation aid to charities and a gradual, rather than precipitous, reduction in future foundation capabilities. But looking beyond the economy's current problems, it would seem reasonable to take into account *the long-term experience* of broadly invested funds as reported above.

In any case, it is noteworthy that only 2 percent of the respondents in the council's survey would see a pay-out rate of less than 3 percent to be "reasonable" (Exhibit 6, Appendix B). A significant majority (62 percent) place their choices in the 4 to 5 percent range – which would seem to represent the sort of effort to balance present and future requirements suggested above. But 15 percent express satisfaction with the 6 percent requirement.

Generally not understood by these respondents, however, is an aspect of the MIR legislation that seems likely to be increasingly troublesome – namely, the formula used by the Secretary of the Treasury to set the annual variations of the requirement. This formula has drawn little attention to date because a 5-year transition period has been in effect for most foundations, and the norm of 6 percent of assets set for the MIR had not yet been reached for them. The effective rate for 1974, the final year of the transition period, was 5.5 percent for foundations established before 1969, which are the great majority.

The 1969 TRA specifies that in determining the minimum investment return rate for the year, the Secretary of the Treasury is to take into account "the relationship which the money rates and investment yields for the calendar year immediately preceeding the beginning of the taxable year bear to the money rates and investment yields for the calendar year 1969." The Department of Treasury has not been forthcoming until recently on how it has set the annual pay-out requirements as against 1969 values, but earlier indications are now confirmed that until 1975 it had relied almost entirely on money rates, and more specifically, on those of 5-year-maturity Treasury notes.[49] On that basis, the pay-out level would have risen well above 6 percent in 1975 – perhaps, indeed, toward 7.5 percent – because of the high returns of 5-year-maturity Treasury notes and other money rates during 1974.

After exploring the consequences of using various other, more broadly representative ingredients in the formula in order to seek to reduce this sort of fluctuation, and finding no adequate solution in so doing, the Secretary of Treasury used his authority to set the 6 percent norm as the rate that would apply in 1975.[50] But for the future the problem remains. A fundamental difficulty in the formula embodied in the law adjusting the MIR lies in the very short time-frames (two selected single years) that the language of the TRA specifies. Experience shows that both short-term interest rates and rates of total return are highly volatile. On short swings they can be far higher than the long-term average of 4.5 to 5 percent as they were in the late 1950s and early 1960s; or they can be much lower, as they were before and after that period. A pay-out formula tied to a comparison between returns in any two single years is thus inherently too unstable to accomplish the declared purposes of the act.[51]

We shall return to this problem in Chapter VI and suggest alternative, preferable bases on which a substantial and reasonable annual pay-out might better be established. Here we only observe again that current evidence – contrary to that adduced in 1969 – seems overwhelmingly to establish that diversified and balanced endowments cannot be expected to earn 6 percent or more per year in real total returns over extended periods of time.

Program Restrictions (I.R.C. Section 4945)

While the 1965 Treasury report recommended many of the measures adopted in the 1965 Tax Reform Act, the former emphasized the desirability of maintaining the independence and flexibility of foundation programming. In 1969, however, Congress took several steps to limit this independence and flexibility. Two of these – the new rules for grants to individuals and the requirement for "expenditure responsibility" on grants to organizations not qualified as "publicly supported" – have been troublesome to many foundations and to many fund-seeking agencies and individuals as well. They are also believed to have inhibited many foundations from engaging in such grants.

The council survey makes clear that the 1969 act has, in fact, had a restraining effect on those foundations that had made scholarships and similar grants to individuals before 1969. Thirty-two percent of the respondents made such grants frequently or occasionally before 1970. Only 19 percent report that they do so now (Exhibit 7, Appendix B). Increasing familiarity with the new requirements for submission of criteria, reporting, and the like may persuade more foundations to return to or adopt this important form of grant-making. However, the negative attitudes of some IRS field agents on this matter[52] and the confusing positions being taken by Treasury and the IRS concerning scholarship grants by company foundations to children of company employees[53] suggest that an educational effort is needed with regard to both regulators and regulated on this area of giving.

Regarding "expenditure responsibility," the statute and regulations are clear that private foundations may make grants to other than "publicly supported" agencies provided certain statutory requirements for record-keeping, reporting, and so forth are met. Thirty-nine percent of the council's respondents reported that they had made contributions to such grantees prior to the 1969 act, while 16 percent made such grants in 1970 and 20 percent made such grants in their last tax year.[54] Thus half of the foundations that were making such grants before 1969 have drawn back from them. In other words, the new requirements appear to have been a real deterrent to some foundations that were formerly prepared to bet on new and often inexperienced grantees. Furthermore, there can be little doubt that foundations that previously had only given to traditional and safe agencies have been confirmed in this tendency by the expenditure responsibility requirements of the 1969 act; thus the majority of the respondents continue to avoid such grants as a matter of policy.

A third set of program restrictions introduced by the 1969 act bars foundations from lobbying for legislation not directly affecting their own functioning and from support of partisan political activities. Here again they are put under stricter constraints than the criterion of "substantiality" that has continued to apply to public charities. There is little basis in logic for greater restrictions in this respect on private foundations than on other tax-exempt entities;[55] yet, very few foundation spokesmen have seemed inclined to contest these prohibitions. This caution is not unwarranted. A few ill-conceived intrusions of foundations into partisan politics during the 1960s – some of which may have been more apparent than real – raised much congressional ire and undoubtedly contributed to the extent to which the private foundations were made whipping boys in the 1969 legislation.

Excess Business Holdings (I.R.C. Section 4943)

One of the most complicated sections of the Tax Reform Act is that which requires divestiture of large holdings of stock in one company. Because the periods allowed for that divestiture are quite lengthy, ranging from 10 to 35 years, there has been an understandable delay in both the issuance of final regulations for this section and action on the part of many affected foundations to begin divestiture. The very substantial security offerings made by a number of foundations in post-TRA years appear to have occurred primarily for the purpose of obtaining cash to meet pay-out requirements. Some indication of the potential impact of the provision when the transition periods run out can be seen in the fact that 13 percent of the respondents to this survey question now have such holdings, with a total value of over $1 billion (Exhibit 9, Figures B-9, B-10, Appendix B). Let it also be noted that these requirements of the act also bear on the birth-rate issue as discussed below.

Exhibit 9 shows a split between various alternative methods of proceeding with divestiture, including sale of the stock-holdings back to the issuing company. Even though the time periods for divestiture are quite generous in the case of foundations established before 1969, it is noteworthy that more than half of the 73 foundations responding that they had excess business holdings indicated that they had as yet made no plans for meeting the requirements of the statute.

IRS Supervision

Prior to 1969, the law required foundation transactions only to be at "arm's length" and "reasonable." Where these standards seemed to be violated, removal of tax exemption was the only sanction available to the government. The 1969 act not only established much more detailed and demanding regulations, but also armed IRS auditors with a range of new sanctions – including penalty taxes against both foundations and foundation managers that can aggregate well over 100 percent of the amounts involved in some situations – to enforce compliance.

IRS expenditures on foundation auditing subsequently increased about eightfold.[56] The reported goal of the IRS has been to cover every private foundation with an audit during the five years 1970-1974, with an additional select group to be audited every second year.[57]

The violations uncovered by this expanded auditing program have apparently not been extensive. Published information of the IRS indicates only the following collections in penalty taxes from the act's inception through June 30, 1974:

Sec. 4941 - Self-dealing	$360,000
Sec. 4942 - Failure to Distribute Income	254,000
Sec. 4943 - Excess Business Holdings	94,000
Sec. 4944 - Investments Jeopardizing Charitable Purposes	24,000
Sec. 4945 - Taxable Expenditures	17,000

The council's survey clearly reflects the increased supervision. Ninety percent of its respondents report having been audited since 1969, and 36 percent have been audited twice during the period (Figure B-11, Appendix B). IRS agents averaged six days on each foundation audit (Figure B-12, Appendix B) – an average which excludes several larger foundations, one of which reported that its audit ran for approximately two and one-half years and covered records from four fiscal years. IRS audit activity was further tabulated by type of foundation and size (Tables B-6, B-7, Appendix B). On the average, company foundations were audited less often than non-company foundations. Foundations with over $5 million in assets averaged two audits since 1969, while those with less than $5 million averaged one.

Survey respondents were asked whether the agents auditing them seemed knowledgeable in foundation law and practice and if they made any efforts to influence the direction of the foundation's grant-making activities (Exhibit 10, Appendix B). Only 78 of the 489 respondents indicated that the agents did not seem knowledgeable about foundations, and only 21 of 530 respondents indicated that IRS auditors attempted to influence their foundations' grant-making activities, particularly by discouraging scholarship and expenditure-responsibility grants. Most foundations, however, found IRS agents to be knowledgeable and reported no efforts to influence programs.

Birth and Death Rates

An important, but still difficult to quantify, effect of the Tax Reform Act is its impact on the creation or birth of new foundations and the termination or death of exisiting ones. In the spring of 1974, the Senate Finance Subcommittee on Foundations asked the IRS for figures on foundations terminations, the number of 501(c) (3) organizations created after 1969, and the asset value of foundations formed after the 1969 Tax Act. Although the IRS indicated earlier in the year that its data were not organized in ways to provide answers to the questions, subsequent communication from Commissioner Alexander addressed these matters.[58] The Commissioner reported that current assets of foundations established since the 1969 Tax Reform Act were some $977 million. On the other hand, organizations classified as private foundations since the 1969 act and which subsequently terminated their exemption produced the following numbers:

	Terminations	*Assets*
Operating foundations	43	$ 1,502,768
Non-operatng foundations	4,892	83,419,552
	4,935	$84,922,320

Although these death-and birth-rate data are not directly comparable, the figures might lead one to the conclusion that the ratio of new private foundation dollars to those now lost to the field is quite favorable. Closer inspection of this information indicates that such a conclusion is not justified. The IRS termination figures do not include the many organizations that discontinued operations as a result of the Tax Reform Act of 1969 before they were classified as private foundations, nor do they encompass foundations that have already distributed substantially all of their assets but have not yet filed a final return. At the same time, while the data on foundation termination appear to be considerably understated, the asset holdings of new foundations, conversely, seem much too high.

Our research strongly suggests that IRS birth-rate figures must include many foundations already functioning before the act took effect, with nothing new about them except that they had to apply for and did receive an IRS exemption letter for the first time after the 1969 act took effect. Then, too, the IRS figures would include a substantial group of organizations established in nascent and irrevocable form as pre-Act testamentary or living charitable trusts, but which matured and only found their way into IRS exempt organization rolls thereafter. Pre-Act foundations in this category would include, for example, testamentary charitable trusts established by persons who died before the Act's effective date but funded at the close of the administration of the estate, after the Act took effect. IRS figures on new organizations also do not discriminate between operating and non-operating foundations. Their figures would apparently also include recently formed entities primarily funded by foundation grants, such as the Drug Abuse Council and The Police Foundation.

Data collected by The Foundation Center for purposes of *The Foundation Directory*, edition 5, reinforce these reservations. Even with access to returns of all organizations filing as private foundations in post-TRA years, the center could identify only about 50 organizations qualifying for *Directory* size limitations ($1 million in assets or annual charitable expenditures of $500,000 or more) with *possible* post-TRA creation dates. Assets of these organizations are about $200 million for the year of record, which does not begin to approach the $977 million figure of IRS.[59] Moreover, a majority of these "new" *Directory* foundations also appear to fall under the "prior law" or "foundation created" categories described above.

In addition to the foregoing, a more recent analysis of the creations and dissolutions of private foundations in a 12-state area shows that a very sharp drop occurred in the creation of new foundations from 1968 to 1970, with a levelling off at the new lower level after 1970.[60] Likewise, there was a sharp increase in dissolutions. Although dissolutions were declining by 1972 and the number of creations was remaining fairly constant, the "death rate" of foundations continued to far exceed the "birth rate." These trends are in sharp contrast to the situation prior to 1969, which showed 1,228 foundations being established in 1968 as opposed to 71 terminations. In these 12 states in 1972, 128 foundations were established, while 605 foundations were terminated (Figure B-13, Appendix B).

The study just referred to also traced the history of the some 1,300 organizations in existence in 1962 that were surveyed for the 1965 Treasury report on private foundations.[61] It was found that 12 percent of them – 160 foundations – are no longer in existence and that less than 5 percent had acted to change their status to that of a public charity. In this group, there were twice as many dissolutions (99) during the three years after the 1969 act became effective as in the previous eight years. Although the study shows that dissolutions were concentrated primarily in smaller foundations, both medium and large foundations also showed an accelerated rate of dissolution after 1969.

The most comprehensive collection of current evidence is that developed by Professor John Simon of Yale Law School in testimony before the Senate Finance Subcommittee on Foundations in October 1973.[62] Citing 11 different and miscellaneous indicators,[63] Professor Simon concludes that early returns provide some support for the "grim estimate" that "The bell may well have faintly tolled for the private foundation; it is now to be found only in captivity and there ar strong doubts about its ability to reproduce."[64]

One element of the grant-making community has clearly benefited from the heightened death rate of private foundations – namely, the community foundation sector. As previously noted, a limited survey in early 1973 identified some 20 community foundations that had received assets valued in excess of $60 million from 91 dissolving private foundations since the act took effect. This flow has continued, and we believe that many other types of public charities have received substantial sums from such terminations. There is also a concurrent birth rate phenomenon. Community foundations currently report less resistance by donors to suggestions that they establish a fund within the commuity foundation, instead of creating a new foundation.

Thus some of the contributions that would have been made to private foundations before the enactment of the 1969 Tax Reform Act are undoubtedly being given to public charities. That appears to have been the intent in the minds of at least some legislators when the more stringent requirements for gifts to private foundations were imposed in 1969. However, it has not been possible so far to determine whether any major shift-over has occurred, and, as pointed out by John R. Labovitz, the diversion of funding from the private foundations as a whole may actually receive less funds because donors will be less willing to contribute without the previous advantages of giving to private foundations.[65]

Birth-and death-rate trends are also reflected in figures on post-act gifts to existing foundations. In the council's basic survey for this report about one-third of the responding foundations received new gifts during their most recent tax year. Tables B-8 and B-9 (Appendix B) show breakdowns for inter vivos gifts and bequests by foundation asset category. About 21 percent received inter vivos gifts and about 15 percent received testamentary gifts; these figures include some 3 percent that received both. Total new money reported was $161.2 million, with two thirds derived from bequests.

A comparison of the council's survey figures with a Treasury estimate of contributions to foundations in 1962[66] suggests that there has been a significant drop in the proportion of gifts received from living donors. The 1964 Treasury survey of 1,300 organizations reported a total of $833 million of contributions to foundations in 1962. Over half of this total was in the form of gifts from living individuals, while approximately 21 percent was in the form of bequests. This ratio change suggests the significance of the much less favorable income tax treatment, discussed below, of contributions to private non-operating foundations. A comparison between the two studies also supports the observation that gifts to foundations have declined in recent years.

Moreover, an indeterminable but substantial portion of these "new" gifts can be presumed to have been made pursuant to estate plans established well before the Tax Reform Act and governed by prior law. The two largest gifts reported, accounting for more than 25 percent of the gifts, seem clearly of this nature. Nor have existing plans escaped unscathed. As one survey respondent put it in explaining the absence of current contributions,

> In our case . . . our founder has been unable to contribute one dime because their [sic] annual contributions are far in excess of 20 percent of their gross income. To avoid drying up we will be forced to limit our grants more or less to annual earned income whereas, in the past, we always paid out much more than we earned because the family channeled its gifts to [the] Foundation.

A prospective donor has many hurdles to jump before he can decide to establish a new private foundation. He must consider administrative burdens, program restrictions, the investment tax, pay-out obligations, and filing requirements. An intangible is the *in terrorem* effect of the possibility of personal liability for penalty taxes under the self-dealing, jeopardy investment, and taxable expenditures sections of the Code. Donors and their advisors may be reluctant to ask people in whom they have confidence to serve as foundation managers in these circumstances. Beyond these factors, three tax rules specifically relate to and directly discourage the process of creation:

> The primary disincentive is the rule which in effect treats a gift of appreciated property to a private non-operating foundation as if the donor had sold the property and realized a gain, unless the foundation redistributes an equal amount (in addition to other pay-out requirements) within a year.
>
> There is a 50 percent to 20 percent differential in the amount that an individual can deduct for cash contributions to a "public charity" as compared with a gift to a private non-operating foundation, coupled with the donor's inability to carry forward excess foundation contributions.
>
> The stock divestiture requirements of the act's excess business holdings rules, not infrequently acting in concert with foundation pay-out requirements, present considerable problems for potential founders whose nest egg consists of a family business interest.

The first two of these disincentives apply for income tax purposes only, but as Professor Simon's subcommittee testimony points out, ". . . most foundation donors want to begin to fund their foundations while they are alive; if they have to wait until death for the foundation to get going, there is a good chance they will not start at all."

The negative effects of the divestiture requirements can also be strong. To abstract briefly what is generally considered the most complex section of the Internal Revenue Code, private foundations are prevented, now and in the future, from receiving a gift of anything but a *de minimis* part of a donor's control stock unless the combined voting interest of the foundation, the donor, and those related to him (or closely associated with the foundation) is brought below 20 percent within 5 years of the gift. Moreover, special liberalizing rules applicable to divestiture of control stock already held by *existing* private foundations do not apply to new control stock gifts. Gifts of control stock not treated as made prior to May 27, 1969, do not benefit from special accumulated earnings rules encouraging to corporate redemptions, and only a 5-year divestiture period is allowed for new gifts, as against 10- to 35-year transition periods for control stock held by foundations on May 26, 1969.[67]

Yet available evidence suggests that control stock is a major source of new foundations of substantial size. Control stock is likely to be appreciated stock. According to the Peterson Commission's report to the Senate Committee on Finance in October 1969, substantially more than one half of all foundations in the $10-million-and-over category have at some time held stock of companies in which the foundation and the donor together owned at least a 20 percent interest – precisely the form of asset covered by the Tax Reform Act prohibitions.

IV

ENDEAVORS AND ACCOMPLISHMENTS

What concretely do foundations do? How do they do it? What do they accomplish? Because of the great differences among foundations with assets ranging from several thousand to several billion dollars, blanket statements and massed statistics give highly inadequate answers. This section, therefore, is devoted to a series of examples arranged under four topical headings: past achievements of prominent, nationally and internationally oriented foundations; a case history of the role of foundations in the development of educational (public) television; foundations focusing on community needs; foundations acting in relation to government. In their varied ways, all are instances of private initiative working to advance the public good.

Large Doings of the Past

Much foundation giving has been in no sense memorable, except perhaps to the institutions, agencies, and individuals it has helped when they have needed help. Nevertheless, there are dramatic accomplishments on record, and no survey should ignore them completely. Not only do we still enjoy the benefits of many of them; past accomplishments also suggest the *potentiality* of equivalent future contributions.

The list that follows catalogues just a few of the more dramatic and measurable achievements for which some of the older and larger foundations have been responsible, or to which they have helped give critical support:[68]

Building a grass-roots network of free, municipally supported, public libraries across the United States;

Bringing to maturity and quality a system of medical education for the United States and Canada;

Devising and implementing a pension plan for faculty members of the nation's colleges and universities that has become self-sustaining;

Increasing faculty salaries and stimulating over half a billion dollars of alumni support for colleges and universities in the decade of the 1950s;

Freeing the South of hookworm;

Reducing greatly world scourges such as malaria, yellow fever, typhus, influenza, rabies, yaws, bilharziasis, syphilis, tuberculosis, and amoebic dysentery;

Promoting systematic research of population issues, advancing improved methods of family planning, and answering the call of underdeveloped nations for technical assistance in these matters;

Developing important instruments for scientific research, including the ultracentrifuge, oscilloscope, mass spectrograph, electron microscope, and the laser;

Helping physics and astronomy to emerge from primitive states and reach their current maturity; and laying the necessary background for radio astronomy to emerge as a science;

Building the research base leading to our current knowledge of DNA, termed by some "the single most significant advance in biology of the twentieth century";

Enabling Gunnar Myrdal to complete the studies that led to publication of *An American Dilemma*, which focused attention on and helped awake awareness of the plight of the American Negro;

The development of policy-oriented research institutes outside of universities and the government, such as the Brookings Institution in the social sciences and Resources for the Future in the environmental field;

The genesis of action-oriented research agencies, such as the American Law Institute, and funding their projects, such as the writing of the Uniform Commercial Code, which for more than two decades has governed most commercial transactions in this nation;

Preparation of the Restatement of the Law and Uniform Code of Evidence to guide understanding of the law in the separate states and to bring some uniformity to it;

Making available to the American people natural areas such as the Cape Hatteras National Seashore.[69]

ETV: A Case History

Perhaps a more useful – because it is more integrated – perspective can be gained by examining the part played by foundations in the founding and growth of instructional and public television through the last quarter of the century. The abbreviated account that follows underscores that just as industrial systems have grown in complexity and cost in this period, so have systems in the service sector. For educational and charitable institutions, as for those that are profit-making, access to substantial amounts of uncommitted capital becomes necessary to take advantage of opportunities and to survive challenges and threats. So it was in educational television.

In the 10 years after General Sarnoff first demonstrated television at the 1939 World's Fair in New York, the possibility of nonprofit educational television channels was not seriously considered. In 1948, however, the Federal Communications Commission "froze" the licensing of TV stations to give itself time to work out a plan for allocation among fiercely competing interests of the remaining limited space on the broadcast spectrum. The National Association of Educational Broadcasters (NAEB), a nonprofit organization formed by a few university holders of commercial radio licenses, used the "freeze" to explore the possibility of educational television as a nonprofit alternative to commercial television.

As a result of a germinal conference funded by foundations at the University of Illinois in 1949, the NAEB and other educational and community groups, public and private, resolved to petition the FCC to set aside some channels in each area of the United States to give educators and communities time to qualify for television licenses and to build and operate nonprofit educational television stations. The Kellogg Foundation gave NAEB just under $300,000 in 1951. Other foundations, including the Fund for Adult Education created by The Ford Foundation in that year, made grants of comparable magnitude to newly created agencies representing educational institutions and community-based and public groups. The grants enabled these several parties to present a compelling case to the FCC.

Over the objections of commercial operators, the FCC in 1952 found a need for nonprofit stations and ruled that "because educational institutions require more time to prepare for television, a reservation of channels is necessary." At the same time, it held that the 242-station "reservations should not be for an excessively long period."

If the nonprofit sector was to hold the ground that it had won, it had to organize itself to act, and quickly. The individual units of that sector had accumulated no capital to take advantage of this unexpected opportunity in an entirely new field. Its members were widely dispersed and poorly prepared to marshall the requisite skills and resources. They especially lacked the expertise to build and operate a technologically intricate system. Augean tasks lay ahead which the service sector institutions considered at a conference in 1953. It, too, was funded by foundations, and the support included both large and small foundations coast to coast.

In the 22 intervening years, the same sort of mix of foundations, in ever more substantial numbers, has helped to realize the potential of television as a teaching tool and to develop a network of some 240 educational television stations now valued at billions of dollars.

With its especial capacity, The Ford Foundation has led others in contributions to the national facilities without which local stations could not have become effective. In all, it has given over $250 million since 1952

1. To create and sustain centers of technical expertise for community groups needing help to apply to the FCC, purchase technical equipment, build and operate stations, and raise money for all these needs;

2. To provide dollar incentives to nonprofit groups to raise money to get stations on the air and keep them there;

3. To make available to local stations quality programs needed to hold local audiences by funding productions at stations such as WGBH in Boston and KQED in San Francisco and at central programming centers that ultimately developed, such as NET;

4. To tie together individual stations into a network in which each can draw on the strength of others; and

5. To develop open circuit and closed circuit television as a tool for teaching in schools and colleges through the funding of experiments in television and programming such as the work of the Children's Television Workshop, producers of Sesame Street.

Ford was, however, not alone. In the 20 years, 1952 through 1971, 200 of 534 foundations with assets above $10 million are known to have made one or more ETV grants.[70] Only 41 of these 200 foundations published annual reports in each of these years. They show that over the period each of the 41 made multiple grants toward ETV totalling some $21,267,000. Obviously, the sum would be greater were equally complete records available as to the other 80 percent (159 foundations) known to have made at least some grants in support of educational television.

The study data also evidence that foundations such as Carnegie, Kellogg, Rockefeller, and Sloan, each with assets well above $100 million and a national orientation, gave for some of the same five purposes as did The Ford Foundation. The grants of such foundations tended to be of substantial amounts consistent with their capacity and the large demands of the electronic media. Perhaps most notable was the work of the Carnegie Commission on Educational Television, established and funded with a grant of $500,000 by the Carnegie Corporation of New York. It issued its report in 1967. When Congress that year undertook federal legislation to assist public television, it drew heavily on the commission's work, and, except for a proposed excise tax on television sets to be used to fund ETV, adopted its major proposals.[71]

Together with foundations in the $10-million-to-$100-million range oriented toward regional and community interests, these larger foundations helped consortia of educational institutions and citizens groups in communities to bring some 240 stations into existence, to equip them, to produce programs for them, and to hook them into a developing network. For the most part, their grants were designed to meet needs that would have been difficult to meet from other sources. Often, time was a factor not permitting canvass of individual contributors. When states and municipalities were unlikely contributors to network facilities located outside their jurisdictions, larger foundations met such needs. When foundations with assets ranging down from $10 million to less than $250,000 contributed to ETV, most gave to their local station for general operating support on a recurring basis, sometimes as often as annually, in amounts ranging from a few hundred dollars for the smaller foundations to several thousand dollars a year for the larger ones. Often these grants were helpful in calling forth other private support.[72]

Grants for ETV by Pittsburgh foundations illustrate what was happening in other areas around the United States. Fourteen of the 20 foundations in that city with assets above $10 million or making annual grants of $500,000 or more have made grants to ETV. Mostly, their grants were to the Metropolitan Pittsburgh station, WQED. The 5 whose grants are known back to 1952 have given in all $1,875,000. The other 9 larger Pittsburgh foundations, whose grants are known for all or some years only as far back as 1959, have given at least $1,418,000. Of 12 other Pittsburgh foundations whose assets range from $200,000 to $6 million, sampled at random, 10 have made multiple operating grants to Station WQED or other Pittsburgh television needs in the period 1959 through 1973, totalling $354,000. Meanwhile, in addition to providing help to national agencies with technical resources on which Pittsburgh Station WQED could draw, The Ford Foundation contributed $2,813,400 directly to it.

In summary, the aid given by foundations, its timeliness, its experimental character, the larger vision it helped to uphold, the support and also the stimulus that it has afforded, all have been critical in the development of the medium both locally and nationally.[73] Moreover, the case history has relevance beyond ETV alone. When communities across the land perceive need to establish conservation commissions, mental health facilities, or similar services, they must have access to flexible capital in order to grasp opportunities. They require technical help, central facilities, and incentives to attract other contributors. Often they must buy time to demonstrate a service and to bring it to maturity. Such needs are more complex today than previously – organizationally, technologically, and financially. With reduced sources of capital committed for charity – or only one source, government – the not-for-profit service sector would be handicapped.

Regional Examples

By far the largest number of foundations concentrate their attention on local communities. A great many award scholarships to local youths or give money to educational institutions for that purpose. They help to fulfill personal aspirations, a productive function where input is difficult to measure. Most act as sources of ongoing support, as well as fall-back sources of working capital for the educational, religious, cultural, and welfare organizations which directly serve their communities.

Almost all of the boards of trustees of such foundations serve without compensation, and they act to keep expenses of administration at a minimum. Few have full-time staff. Almost none of the 22,000 - 24,000 with assets under $1 or $2 million make payment for staff. Their assets limit them to response to a few community causes and institutions. They do not draw attention to their grants nor issue public reports beyond those required by the Internal Revenue Code.

Slowly, the same heightened expectations of people that affected government programs in the last two decades have been affecting these foundations. Many private foundations with community-oriented programs, particularly those with assets of several million dollars or more in the larger metropolitan areas, are changing in program and style in response to newly perceived community needs.

They now make more grants to relieve inner-city distress, to stake newly created agencies, and to extend services to minorities. They are communicating more with each other about their work and in many places cooperating in the collection of information to guide grant decisions. The following accounts of foundation performance in San Francisco, Spokane, and Boston are illustrative.

San Francisco, California

Twenty-three foundations in the San Francisco Bay area, most of which have staff support, meet together periodically to survey community needs and to exchange information and experience. Members of the group vary in size and style from the James Irvine Foundation, which has assets over $100 million and makes gifts to more traditional charities, to the Vanguard Foundation whose 12 donor-trustees, aged 20 to 26, in 1972 contributed $73,000, from which they authorized grants of $50,000 for projects "too controversial or too risky to find funds at most other foundations."

Early in 1974, these 23 foundations issued jointly *A Newsletter For Foundations Of Northern California*. It featured a story about grants of Bay Area foundations to counteract the "battered child syndrome":

Late in the 1960's the Rosenberg and van Loben Sels Foundations, with assets of $13 and $5 million respectively, began funding activities that were climaxed by a 1969 symposium on "Children in Peril" and a series of programs on the subject over KQED, a public TV station, and itself a product of foundation grants. Those two foundations – joined by others including the Luke B. Hancock, Zellerback Family, and Marshall Steele Sr. Foundations, with capital of $8 million, $15 million and $500,000 respectively – had by 1973 helped in establishing Northern California's principal therapeutic and crisis center for battered children in the Oakland Children's Hospital and the San Francisco Extended Family Center, which works with parents who abuse their children. The Rosenberg Foundation had established also a "hot line" used by citizens to report incidents of suspected child abuse and by parents who call about their own abusive tendencies. At San Francisco General Hospital, long-term research on the battered child syndrome has received funding from the San Francisco Foundation, a community foundation with capital of $46 million. The work of these foundations resulted in the establishment in 1974 of a comprehensive city-wide crusade to protect battered children.

In this case, institutions in the private sector, aided in their initiative by foundations, are leading in the amelioration locally of a universal ill and at the same time energizing agencies in the government sector to respond to the need.

Spokane, Washington

Spokane, population 170,000, is a neat, clean city, proud of its rural setting in the "Inland Empire" area of Washington State. Citizens there share a sense of community cohesion and neighborliness and a commitment to voluntarism. This small city may be slightly luckier than others of comparable size in having seven foundations with assets over $500,000, one with assets above $6 million, one above $4 million, two above $2 million, two above $1 million, and the Spokane Community Foundation with $600,000. Of the donors of these funds, outsiders would be most likely to recognize the name of Eric Johnston, movie czar of the 1950s. His widow and married children and their families in Spokane serve as trustees of an endowment of $2.7 million. Trustees of the other foundations can also be identified as donors and heirs or persons closely associated with them, such as business associates, attorneys, and bankers or banks. With few exceptions, they are residents of Spokane.

One who inspects the 1972 federal tax returns for Spokane's private foundations, available upon request at the New York or Seattle collections of The Foundation Center, will learn that the Sacred Heart Medical Center was engaged in a building campaign that year, for several foundations made capital-sized gifts to it. One was a generous contributor of $60,000 to the building fund of St. Joseph's Children's Home, while another favored college programs in the Spokane area, giving much toward scholarship aid. Almost all of them were solid contributors to the city's United Crusade and to old-line national agencies and the usual array of local service agencies such as Boy Scouts, Catholic Charities, Goodwill Industries, the Spokane Symphony, and Sing-Out Spokane.

One contributed $325,000 to the Spokane Park and Recreation Foundation, a city unit. Several made large grants to the State of Washington toward the cost of the main auditorium to be built for EXPO '74. The EXPO buildings replace a deteriorated area cleared in governmentally subsidized urban renewal, and the City of Spokane will inherit the reconstituted site and the auditorium and convention facilities when EXPO closes.

Except for one foundation, not many grants found their way out of Spokane. Few of the reported grants are either greatly "innovative" or socially activist, and critics could fault the Spokane foundations on this. On the other hand, from the nature of the institutional recipients and the reported purposes, one can expect that each grant went to help some worthy group and was of general benefit to Spokane and its citizens.

Boston, Massachusetts

In 1969 a group of charitable grant-makers in Boston formed The Associated Foundation of Greater Boston, through which they study the city's needs and develop facts upon which their individual boards of trustees make their independent grant decisions. Today over 30 foundations participate in the association's program. They include private foundations with less than $1 million in assets to the city's community foundation whose portfolio is valued at $73 million. The Associated Foundation of Greater Boston is only one of a growing number of formal cooperative arrangements among foundations in cities, states, and regions of the United States. It has stored on computers more than 2,500 grants made by its members from 1971 through 1973. The easy availability of that information has helped in developing the four short case histories below, which describe grants that are illustrative of the kinds of community needs to which local foundations and associated groups are responding in Chicago, Cleveland, Kansas City, St. Louis, Los Angeles, Atlanta, Winston-Salem, and other areas.

East Boston is a predominantly Italian and Roman Catholic neighborhood in the shadow of the control tower at Logan International Airport. Father "Mike" Groden, who heads the Planning Office for Urban Affairs, believes that Roman Catholic schools in East Boston, which operate independently under several clerical orders, can achieve economies, be more efficient, and improve offerings to pupils, if they will collaborate. The schools, already threatened financially, cannot expend the extra money to work out the new systems that appear to be needed. Accordingly, at least four of the foundations, responding to Father Groden's applications, have contributed for planning to enable the "East Boston Collaborative" to test the theory. Governmental money is not available to the Collaborative because of constitutional limitations.

Neighborhood groups, church denominations, and other sponsors in the nonprofit sector have sought to respond to the call by the federal government to build low-income housing. Unfortunately, the high degree of organization needed to locate sites, obtain municipal permits, qualify for federal aid, and design, build, and operate housing projects is outside the experience and beyond the skills of many such groups. To meet these complexities, Greater Boston Community Development, Inc. (GBCD) was formed in 1970 and has been sustained with grants from national and local foundations as a nonprofit housing packager. Its consultants and staff of architects, lawyers, planners, and accountants are made available only to nonprofit sponsors of subsidized housing. Recent commitments of $150,000 by local foundations to GBCD are being used to adjust its program to crises created by the moratorium on building and other major shifts in federal housing policies.

Although volunteers were working effectively in the school systems of other cities, they were not used in Boston schools before 1966. In that year and the two following years the Massachusetts Council for Public Schools raised over $50,000 from local foundations to start a program under which it has trained and placed over 1,500 volunteers in public schools in Boston and its suburbs. Now most funding for the program comes from the participating public school system. Foundation money was needed at the outset, however, to encourage a reluctant school system to try the concept and to enable it to establish a free format outside of a bureaucratized public system. Current commitments of over $50,000 to School Volunteers of Boston from several foundations attest that they continue to support the volunteers as they seek funds to start new projects within schools, such as a recently established bilingual education program.

When, in 1973, federal funding cutbacks threatened severely to limit summer recreational and job programs for Boston youths, foundation members of The Associated Foundation of Greater Boston called a joint meeting of the private and public service agencies doing such work. The foundations offered to give over $300,000 to be allocated primarily to those service agencies that agreed to consolidate certain programs, jointly use resources and carefully evaluate overall results as the basis for estimating needs in later years. In this case, The Associated Foundation of Greater Boston promoted cooperation between the local public and private sectors to meet gaps that had developed in federal support and to keep the tax cost of programs at a minimum.

Relations to Government

"Nor is it enough to say that, if private foundations cease to exist, government would have to take up the slack. If foundations are on a parallel course with government, they are on a very slender reed," So counselled Senator Vance Hartke of Indiana from the chair of the Senate Subcommittee on Foundations in May 1974.

Are foundations on such a course? We have seen that in educational television they helped the private sector to lead government into a publicly desired course; and in San Francisco, Spokane, and Boston their grants have both filled gaps left by federal and local governments and helped to mobilize the private sector behind government programs, such as low-cost housing. Symbiotic relationships often develop between private and public programs. That is the nature of the private-public relationship in our nation.[74]

The following additional examples of recent foundation programs spotlight current work of foundations and illustrate how they often can do what government cannot do, or cannot do so well.

The Robert Wood Johnson, Richard King Mellon, Kellogg, Commonwealth, Rockefeller, and other foundations have since 1970 given $2 million for the start-up core costs for the Institute of Medicine, a new unit of the National Academy of Sciences. Though federal money for start-up was nonexistent, government will be a chief user of the institute's services. Already, federal agencies have contracted with it for $6 million, mostly to do congressionally mandated studies. In this instance, foundations are helping to provide government an independent, nonpartisan source of information that it needs to help work out how our nation will allocate hundreds of billions of dollars in the future for delivery of health care.

In 1973, the Twentieth Century Fund, a private operating foundation, committed $300,000 to establish a National News Council "to promote better performance by the print and the electronic media and to defend freedom of the press." No institution can be perfect. Who keeps the press honest? Who draws public attention to its errors and wrongs? The council is an experiment with a citizen board to serve those functions. CBS supports the concept while the *New York Times* does not. The National News Council is an experiment that if not totally off-limits to the government because of the First Amendment, is clearly not the kind of function that it should or would undertake.

Although revenue sharing has large implications for the future of American federalism, there appears to be little or no monitoring by government agencies of its effect on the poor, the degree of citizen involvement, and compliance with civil rights requirements. To enable citizens groups to do such monitoring over a two-year period, the Edna McConnell Clark Foundation and the Rockefeller Brothers Fund, in 1973, committed a total of over $660,000. The League of Women Voters Education Fund, the Center for National Policy Review, the National Urban Coalition, and the Center for Community Change will each do continual monitoring through community organizations to trace in detail the processes involved in allocating, expending, and evaluating revenue sharing funds. A National Clearing House established by the four sponsors seeks to increase public understanding and involvement in this important new concept for meeting community needs.

In 1972 and 1973, according to Foundation Center records, foundations had made 203 grants, ranging from $5,000 to $400,000 and totalling $7,964,000, toward various legal programs. Many of the grants were made to public interest agencies to enable citizens to gain access to justice in courts and administrative tribunals so as to protect individuals and public interests. A group of foundations in Boston, for example, including that city's community foundation, make it possible for the tenants of public housing to represent tenant interests to the city and its Public Housing Authority. The Norwin and Elizabeth Bean Foundation (assets of $4.5 million) and other foundations in New Hampshire support New Hampshire Child and Family Service in its program to advocate the interests of children and families to state and local officials.

Thus do foundations not only often work alongside governmental agencies to fill gaps in institutional funding and to provide the free funds that permit flexibility and experimentation, but so also do they serve on many fronts that "eternal vigilance" of the citizenry which alone can keep government and its myriad units alert, efficient, and honest.

V

CRITICAL ISSUES: PRO AND CON

Post-1969 Perspective

There can be little doubt that the 1969 Tax Reform Act has done much to clean up foundation abuses, to reduce the casualness with which some foundations were managed, and to induce a heightened sense of philanthropic purposefulness on the part of many foundation trustees and staff members. Indeed, the private foundations now must function under regulations and sanctions far more demanding than those that apply to any other type of charitable organization. Moreover, a greatly stepped-up program of IRS auditing and supervision is there to insure that foundations do so.

There are features of the 1969 act that seem overly restrictive of private foundations and some that relegate them to a dubious sort of second-class citizenship. The report will come back to these concerns in the recommendations of part two of Chapter VI. But the task of so regulating foundations that they must meet *bona fide* charitable purposes has been accomplished, and on the whole accomplished well. That being so, we suggest that to regard foundations as marginal institutions and objects of suspicion is no longer warranted.

It is in this context and with this perspective that Chapter V examines the main forms of criticism and doubt that continue to be directed at foundations. But at no point do we seek to claim perfection for them. They can no more attain it than can any other human institution. Recommendations abcut how foundation performance often can and should be improved are discussed in part one of Chapter VI.

Critics on All Sides

Foundations will continue to be subject to various criticism: For example, from those who would have foundations be more directly involved in social change and those who would have them be less so; from those who would have foundations emphasize novel ventures and explorations and those who plead the needs of existing charitable institutions and programs; from those who find certain foundations to be too "liberal" in their orientation and others who regard the whole field as too much tied to the status quo; from those, too, who feel that their segment of society or their particular interests are underrepresented in foundation giving; and, often, from those who have sought grants and failed to gain them.

With respect to many of these criticisms and their inherent conflicts, we suggest that some general principles enunciated by the directors of the Council on Foundations remain sound – namely,

> Grant-making foundations differ greatly in origin, size, purpose, organization, and mode of operation. In this diversity they correspond to the mutliplicity of society's *bona fide* charitable needs, and because of it, satisfactory generalizations about foundations are difficult. Within their general philanthropic mandate, it is fitting that some foundations should be concerned particularly with the search for fresh solutions and innovative lines of development while others center more on the support and strengthening of existing institutions of proven worth; that some should favor progressive social causes and others more conservative ones; that some should focus on local or regional needs while others seek to extend their scope of effective concern to human welfare the world around. In these respects no orthodoxy can properly be prescribed for foundations though partisans of various limited interests keep trying to do so. The one common requirement is an essential public spiritedness.

Another way to put this is that the institutions and programs to which foundations may give money without penalty must all fall within the scope of the federal government's definition of what is "charitable," "scientific," "literary," or "educational." In this sense they all conform to national policy. It is a policy that continues to be capacious, valuing multiple and diverse initiatives.

Accountability

Even so, it has sometimes been argued, private foundations are insufficiently accountable. They lack both the "bottom-line" imperatives of profit-making institutions and those checks and balances that apply to "public charities" because of their dependence on multiple sources of support. Against this position, however, are to be set important rejoinders.

First, except in a miniscule percent, the beneficiaries of foundations are those same "public charities," and in the case of all other grants, stringent regulations now require foundations to account for each dollar spent. Second, in the management of their fiscal affairs, the reports they must file and make available, the audit program to which they are subject, and the continuing congressional oversight under which they have been placed, foundations are, in fact, now more strictly accountable to public officials than are any other nonprofit, tax-exempt organizations of our society. Third, even the most innovative programs of foundations are subject to the ultimate test of the marketplace. If they are not picked up by some public body, they are not likely to have wide influence. Fourth, the salutary capacity of critics to be critical in our society spares foundations to no greater a degree than it does other institutions. On the whole, both foundations and public understanding benefit from such scrutiny and criticism, even though in particular instances it may tend toward sensationalism.

Finally, the relative independence which foundations enjoy in their choices of both general program objectives and specific objects for support is intrinsic to what they have to offer that is useful in a free and open society. If foundations were to be put on a tight rein of program accountability, or if they were to be made subject to quick expectations and demonstrable payoff, the loss would be felt in the capability for venturesomeness, critical thought, and self-determination of many of the agencies and institutions that can now call on foundation support.

Accessibility

Ready entree for less-privileged groups to the beneficence of foundations and other forms of private philanthropy is a genuine problem and one not readily resolved. Over the past decade or so the injustices suffered by minority groups and the poor have received considerable foundation attention and assistance, and indeed without it, such limited progress as has been achieved by these groups probably would be lagging even worse that it is. On the other hand, many foundations remain traditionally oriented, and there are also some that are deliberately cautious, giving only to established institutions at minimal risk. In some respects the 1969 act reinforced the latter tendencies in foundations already marked by them. But the act does not, in fact, exclude foundation entry into experimentation, social action, or controversy.

None of this is to suggest that enough foundation support has been, or is, available to risky causes and the socially underprivileged. It *is* to suggest that there is not enough foundation money to go around. One can turn to almost any group, including such traditional ones as universities and museums, and be exposed to sharp complaints about its excessive neglect by the foundations.

To decide for themselves where and how they will place their support among all the many competing interests and opportunities which have just claims for assistance is a proper prerogative of foundations. Unquestionably, however, in most cases gaining foundation support is harder for the less sophisticated and less articulate than it is either for traditional "upper-class" institutions or for minority agencies which have developed promotional skills and a track record over a period of time. Some foundations and "middleman" organizations are sufficiently aware of this problem to try to assist new inexperienced groups in forming manageable and supportable proposals. There is clearly a need for more foundation involvement of this sort.

Donor Influence

It is sometimes argued that foundation boards should somehow be required to be broadly representative and that limits should in particular be imposed on the influence of donors and their families.

One form of the argument holds that since a fairly rapid redistribution of wealth is a normal objective of a democratic society, it is anomalous for our government to let individuals or families retain control of large assets, and get a tax advantage in the process, by setting up foundations on whose boards they retain a dominant position. To this argument, it can properly be rejoined that wealth put in a foundation is wealth dedicated to charity. It cannot be used for private purposes. Stringent limitations imposed by the 1969 legislation insure that. They preclude prolonged retention of interest in closely held businesses, compel substantial annual distributions in support of charitable activities, and require full annual reports by foundations to the Internal Revenue Service, to state authorities, and to the public. Basic is that a foundation's resources must be spent on public purposes. In this very important way, wealth in a foundation *is* redistributed wealth.

Another form of the argument is more political than economic. It holds that decisions over the allocation of (tax-exempt) foundation assets will better meet the needs of a democratic society if they are made by broadly representative boards instead of by "elitist" donors and associates.

There can be no doubt but that the racial and ethnic minorities and young people have scanty representation on foundation boards – and to a less degree this is also true of women.[75] Nor can it be doubted that individuals from these groups would often bring to foundation governance useful perspectives and competencies and thus would help foundations to be more open to and more knowledgeable about critical areas of social concern. But to hold these views and work to advance them, as the council has done, does not mean that either a forced limit on donor influence or a requirement of broad public representation are proper matters for legislation. Indeed, such steps would seem likely to be counter-productive on a number of counts.

In the first place there is the value of diversity. A function of foundations is to be independent, self-determining alternatives to government in the meeting of social needs. Concerned donors and their offspring often represent valuable voluntary commitments of thought and concern, as well as of dollars, and they thus contribute to the energetic pluralism that we want in the nonprofit service sector of our society.

There is also the matter of efficacy. In many instances family-directed foundations have shown, and are showing, broad and knowledgeable sensitivity to social needs.[76] Conversely, there are many other instances where publicly – that is, non-family – controlled charities have been run more to the benefit of their managers than the causes they claim to support. Indeed, if one surveys the broad sweep of foundations in all their diversity, it seems clear that "independent" boards assure no higher degree of creativity and innovation in the conduct of charitable functions than characterize many of the foundations under substantial family influence or control. In many instances it is the latter which seem to be most sensitive to the underprivileged and the boldest in efforts to do something with and for them.

Finally, the incentive factor needs also to be considered. Donors' expectations of participation and leadership are important considerations in the creation and augmentation of foundations, and these incentives should especially not be discounted in the light of the many other disincentives that now pertain to the birth and growth of foundations.

In summary, while foundations generally may be expected to do better, and perhaps also gain better public acceptance, when they reach out to include, both on their boards and in other of their decision-making processes, persons drawn from the underrepresented segments of our society, it seems to us clear that this broadening and ventilation should be accomplished as a process of evolution, prodded on by exhortation and example, rather than be enforced through legislation. This is to say that the same restraint that government exercises with respect to other charitable institutions in the matter of board composition should apply to foundations too, unless they were shown not to be serving genuine needs of the society in legitimately charitable ways. Such a demonstration appears to be generally unlikely, given the other constraints under which foundations have been put since 1969.

"Whose Money and to What Effect?"

We referred earlier to increasing influence within the government of a view that the deductibility of gifts for charitable purposes represents "government expenditures" or "government subsidies." This way of looking at the charitable deduction is advanced by some who urge its elimination or its possible replacement by direct governmental grants. Any such developments would unquestionably discourage the creation of new foundations and the addition of money to existing ones. Even more threatened by this tax-expenditure view of charitable giving is the life of the myriad public charities that depend on a constant in-flow of voluntary support, including that from foundations. Therefore it seems appropriate here to look more fully at this set of issues.

Is a gift to one's church, the United Way, or one's college a personal consumption just like renting an apartment, buying a suit of clothes, or eating a steak? Should the income tax system be stripped down to make it a much simpler mechanism for raising revenues and that alone, or should it continue to contain incentives for channeling personal expenditures toward what have been judged to be socially desirable ends? Do the funds to which charitable exemptions and deductions attach represent "government money," or money that belongs to the charitable sector to which it has been committed?

There are, we must recognize, basic and therefore irreconcilable differences among both tax experts and economists on these three interrelated questions.[77]

With respect to the first, we hold with those who maintain that a charitable contribution is distinct from personal consumption and therefore that an individual's taxable income should not include the amount contributed because it helps to produce common social goods and benefits rather than goods and benefits that pertain mainly to one's self or to one's family. As Professor Bittker has argued before the Filer Commission and elsewhere, this view appears to be better grounded in history and also to be more realistically related to what voluntary institutions and the private giving which sustains them mean in the American society. They are indeed part of its very fabric and have long been so.[78]

With respect to the second issue – tax simplification – those who advocate that the income tax system should be confined to revenue raising sometimes claim that the support needed by the private nonprofit service sector could more equitably and efficiently be achieved by providing federal funds to match an individual's charitable donations. While these proposals have considerable appeal when considered in the abstract, when examined in detail their practicality is questionable on a number of grounds, including heightened possibilities of political interference, the complications which any such matching-grant system would create for governmental administrators, and the church/state issue.

The third and most frequently debated question is whether tax deductions and exemptions for charity represent government expenditures or subsidies. Viewed as government outlays, charitable exemptions and allowances strike these observers as undemocratic, because these so-called outlays are allocated not by the Congress but by private institutions and private donors. A strict revenue-raising approach is seen as a remedy for this evil.

But if this is an evil, it exists only to the extent that exemptions and allowances are truly governmental expenditures or subsidies. Under Professor Bittker's analysis, they are not and cannot be governmental outlays: funds given to or distributed by charitable organizations are not considered part of taxable income in the first place and therefore are not available for governmental "expenditure" or "subsidy." Even if the Bittker view is not accepted, the notion that exemptions and deductions represent government outlays rests on the unproved assumption that what society chooses not to tax is money under governmental control and therefore the subject of a governmental expenditure or subsidy. In this view, as Irving Kristol has observed, "Whereas a subsidy used to mean a governmental expenditure for a certain purpose, it now acquires quite another meaning – i.e., a generous decision by the government not to take your money. . . At issue is a basic principle of social or political philosophy – the principle of what used to be called 'private property'."[79]

It is at this root level, we submit, that the tax expenditure view of charitable giving must be faced. When in the past Congress has decided for reasons of equity or social purpose that certain classes of activity should not be taxed, this used to be understood to be a decision not to take money from people who own it. For ourselves, we continue to believe that funds *not* taxed belong to the people, considered as individuals and in voluntary associations, and *not* to the government.

Indeed, our historic traditions point the latter way. We have never indulged the general assumption that all untaxed funds belong to the government.[80] And when our elected representatives, responsive to the electorate, vote to exempt certain purposes and activities from taxation and to provide tax deductibility for gifts supporting those purposes and activities, it is reasonable to conclude that those are dcisions designed to leave citizens in control of their own money for use or allocation among those designated common purposes and activities, rather than to consider those deductions and exemptions to be money which the government somehow has spent or provided.

The tax exemption of charities and the tax deductibility of charitable donations clearly imply, and are predicated upon, those activities and donations being committed to the service of the public good on a nonprofit basis. In this sense they embody a public trust and properly should periodically be assessed for the degree to which they do or do not meet *bona fide* public, as against solely private, interests and needs. But none of this makes those resources and donations properties of government and hence something that government can expend or provide as subsidies. It means, rather, that in the experience of this nation many elements of the public good have been seen to be immensely well, if not perfectly, served by the cultivation of extra-governmental initiatives and by the availability of nongovernmental resources to help them to serve a broad range of charitable needs.

This fact leads directly to a more pragmatic consideration. If charitable donations and endowments built up from them are held to be government money – described either as costs, expenditures, or subsidies – the implication is clear that centralized authority rather than plural initiatives should have control of – or at least be entitled to determine – their management and disposition. Whereas that might lead to greater equity in our society, it would be at the expense of freedom and flexibility and entail the loss of much of the creative energy that flows from personal commitment and a sense of self-direction in individuals or institutions addressing themselves to helping to meet public needs. Moreover, whether further centralized control over the distribution of funds now going to charitable purposes could assure their more efficient allocation and expenditure is problematical, to say the least.

On a still more practical level, the evidence is that tax deductibility for donations has served as a very important encouragement to charitable giving by private individuals and, as such, it has been an important support for many of our key nonprofit service institutions and agencies. It has channelled into public purposes more dollars than would otherwise have been taken into the general revenue by taxation.[81]

Moreover the greater incentives for giving which the current tax system affords to higher-income individuals has meant that they carry a very substantial portion of the voluntary support of many of the country's charitable institutions. For example, in 1970-1971 some 75 percent of the voluntary support received by a broad range of public and private institutions of higher education came from less than 5 percent of the donors, in gifts of $5,000 and more.[82] And it is to be noted that some 22 percent of this private giving went to public colleges and universities for purposes such as augmenting student aid programs, supporting innovation, and encouraging the pursuit of excellence in both teaching and research.[83] The importance of independent private funding to those objectives is reflected directly in the determined efforts of many public institutions of higher education to secure it.

Examples are also to be found in great national resources, like the National Gallery of Art in Washington, which today serves over 1.25 million visitors a year, regardless of their ability to pay, and the Sloan-Kettering Institute for Cancer Research in New York, created by the gifts of individuals. The evidence is also visible in thousands of towns and cities throughout the land in the form of YMCA and YWCA buildings, 4-H Club and Girl Scout camps, Audubon Nature Centers, local wildlife and forest preserves, reading libraries, physical and mental rehabilitation clinics and parks, swimming pools, tennis courts, hockey rinks, and other recreational facilities constructed and supplied for general public use through private fund drives. Almost all such drives hinge on the reality that 50 percent or more of the money must come from the early commitment of the 5 percent or so upper-tax-bracket persons who are consistent mainstay givers to such causes.

In many of these illustrations, including the universities, the private support provided by persons in higher tax brackets probably has meant that certain things are being done, and enjoyed, that might never have been initiated by public officials drawing on the public treasury. The results, we would insist, have been to create and make available to broad sectors of the American society far finer and more varied opportunities for education, health, various other social services, and the use of leisure than would otherwise have been the case. At the same time, because these benefits are so widely enjoyed, it is probable that there would in many instances have to be real, rather than metaphorical, government expenditures to fill the gap, were the large gifts that now launch and support such undertakings to be reduced. That is to say, the contributions which upper-income persons are making when they make large charitable gifts would have to be made up out of the general revenues at greater cost to the ordinary taxpayer.

Reaffirmation

Major issues that we have been facing in this report are (1) how important to the character and well-being of our society are the functions foundations perform, including their contribution to diversity and (2) how well are foundations meeting the opportunities and responsibilities currently afforded them.

Neither question can be answered with any high degree of precision, for the issues lie beyond quantitative measurement. This report has, therefore, not pretended exact answers. It has, however, developed and presented evidence that seems to its authors to be objective and convincing.

With respect to the second question, which has to do with the efficacy and purposefulness of existing foundations, our findings are that the 1969 act has done much to rid the field of abuses and stir many of its members to a more conscious and active sense of philanthropic obligation. Moreover, what the foundations can contribute has perhaps never before been more required. With many grievous social problems calling for strengthened effort and fresh approaches, with severe cutbacks in the availability of federal funds, with private sector educational, medical, and other social welfare institutions in grave financial trouble, the resources and the initiatives that foundations can provide are desperately needed. The record of useful foundation participation in the attack on such problems over the years is both strong and far-reaching; it extends into communities, small as well as large, throughout the United States; it also reaches out to issues and developments of worldwide significance.

With respect to the first question, which is fundamental, we have already shown our predilections but also sought to document how the private initiatives and responsibility represented in philanthropic giving and service make for a more humane, less bureaucratic, more open, and more variegated society than where the resources for and management of all social needs are under direct governmental control. This is in no way to gainsay the importance of governmental programs. Indeed, the magnitude of the needs and aspirations of Americans for more and better education, health care, and almost all other social services far outstrips the capacity of private agencies and resources working alone. It is not an either/or matter. America needs well-conceived, broad-reaching, equitable governmental programs of social and cultural service. But there are also great advantages, not to be lightly surrendered, in the stimulus, competition, flexibility of response, readiness to question and to dare, and in the opportunities for personal commitment afforded by independent minds and agencies working in these same areas.

It seems appropriate, then, in concluding this chapter to revive the strongly affirmative words of the Treasury report of 1965 about philanthropy and foundations as assets of the American society:

> Private philanthropy plays a special and vital role in our society. Beyond providing for areas into which government cannot or should not advance (such as religion), private philanthropic organizations can be uniquely qualified to initiate thought and action, experiment with new and untried ventures, dissent from prevailing attitudes, and act quickly and flexibly.
>
> Private foundations have an important part of this work. Available even to those of relatively restricted means, they enable individuals or small groups to establish new charitable endeavors and to express their own bents, concerns, and experience. In doing so, they enrich the pluralism of our social order. Equally important, because their funds are frequently free of commitment to specific operating programs, they can shift the focus of their interest and their financial support from one charitable area to another. They can, hence, constitute a powerful instrument for evolution, growth, and improvement in the shape and direction of charity.[84]

VI

RECOMMENDATIONS

To Foundations

There is much room for improvement in foundation performance. It is, however, of a kind best achieved through concerned effort of foundations. Both to serve charity better and avoid punitive legislative reactions, foundations should carefully weigh all criticism directed at them, for the characteristics that give strength to private foundations often contain the seeds of weakness.

Personal contributions of money and service rendered without compensation, which add to charitable resources, can also offer excuse for less than full attention to foundation business. Though small boards whose members are compatible can act with dispatch, they can close themselves to valuable outside perceptions. The desire for simple organization and minimal expenditure in giving away money can also result in insufficient staff or study to give it away well. The freedom of discretion and lack of operational involvement that make foundations flexible can isolate them from "real life" and render them less attentive to the concerns and sensitivities of others than they may be aware. The following recommendations are made to help private foundations guard against hazards to which they are subject.

Recommendation 1: "Not our money, but charity's" should be the key principle guiding each act of foundation donors, trustees, and managers, whether in earning money or giving it away. To minimize any tendency to act out of concerns related to personal benefit or convenience, boards of foundations should consider and adopt policies to implement this principle.

Recommendation 2: Periodically, each foundation should critically reexamine and redefine its rationale, purpose, programs, policies, and procedures to take account of changing circumstances and to assure attention to matters that might otherwise not be directed to its concern. Investment portfolios should be subject to frequent systematic review and to measurement of results against those achieved by other institutional investors. Even more important is the development of appropriate procedures for the evaluation of funded projects and a periodic review of overall programs. Useful lessons can often be learned to guide further decisions. Moreover, critical assessment of both their own performance and that of their grantees can be held to be an appropriate part of the accountability that foundations owe the public on the funds entrusted to them. Because foundation grants and programs differ so much in size, purpose, and other characteristics, no single method can be prescribed for assessing either grantee performance or overall program. But, often, outside viewpoints will add objectivity and broader perspectives to the judgments of foundation staff and trustees.

Recommendation 3: In order that programs may be more representative and relevant, foundations should make a special effort to recruit board members and staff from groups not traditionally represented. The paucity of board members drawn from certain racial and ethnic minorities, women, young people, and persons in occupations disassociated from the profit-making sector suggests that more foundations should affirmatively seek to identify and consider for board membership and staff positions individuals who can bring into the foundations both relevant competencies and the points of view of these groups. In many cases, the addition of experts and professionals in fields related to the foundations' programs should be considered.

The use of advisory panels and of consultants is among the many other ways that foundation boards can open themselves to a range of viewpoints in both their periodic examinations of purpose, policy, programs, and procedures and their ongoing business.

Recommendation 4: Foundations should search for ways to inform relevant audiences about their objectives and their work. While the 1969 act imposes more demanding reporting requirements upon foundations than on other nonprofit institutions, the public needs and deserves even more information if it is to understand and use foundations effectively. Published annual reports, periodic newsletters, press releases, and interviews with the media, are among the methods to be considered.

Recommendation 5: Foundations should develop policies to guide their relationships, and fulfill their responsibilities, to applicants and recipients of grants. Foundations that comprehend that the success of their programs depends upon the initiative, ingenuity, and performance of their grantees will accord these voluntary agencies the respect and courtesy they deserve. Prompt processing of grant requests improves applicant relations and can distinguish foundation responses from the more cumbersome ways of government. In particular, a clear statement of the foundation's grant-making areas should be available to potential applicants to save them the effort and frustration of applying when aid cannot be forthcoming because of policy or other limitations. Foundation procedures should also assure that before commitments are made, consideration is given to whether they may entail ongoing responsibilities and, if so, how they are to be met.

Recommendation 6: Foundation board members should periodically examine the duties of trustees, the time that they can commit to their responsibilities, and the need for or capability of staff to conduct the foundations's business. The increased needs and expectations of charitable applicants, the interrelationship of foundation and government activity, the greater complexity of our society, and the administrative burdens imposed by the Tax Reform Act, all necessitate closer board attention, sharper information-gathering systems, and more professional operation than in earlier eras.

Recommendation 7: Individual foundations should seek ways to increase communication, coordination, and cooperation with other foundations and other grant makers with related program interests as a way to increase performance and capability and to reduce duplication of effort. The potential utility of joint fact-gathering, joint staffing, joint administration, and joint funding should be considered, especially by small foundations.

Recommendation 8: Foundations should consider how best to apply the proceeds of their limited capital for those tasks that cannot, will not, or cannot so well be done by others, including government, and how to make each invested grant dollar yield more than a dollar's value to charity. This often takes patience as well as imagination – and a readiness to trade on the ideas of others, not only to ride one's own.

These recommendations are made with the recognition that they have varied applicability. Many foundations, particularly mature foundations of large and intermediate size, have long followed such precepts; and ever-increasing numbers of others, impelled in part by the Tax Reform Act of 1969, are embracing them. Most of the recommendations will apply with greatest force to the approximately 800 foundations with assets above $5 million, the scale of whose annual grants may justify formal organizational structures. Some of the recommendations will have less relevance for the approximately 1,700 foundations with assets between $1 and $5 million and much less for the approximately 22,400 whose assets are $1 million or less. Since the annual grants of foundations in the last category average less than $20,000, recommendations as to review of organizational structure, need for staff, and publication of annual reports will be realistic only for a limited number. In essence and spirit, however, the recommendations counsel care, concern, responsibility, accountability, and humility. Those attributes are required of every grant maker, great and small.

Recommendations Relative to the 1969 Act and Other Issues

The recommendations that follow are for the most part specific and detailed. The actions of policy makers will often depend more on broad perceptions of the public interest. Because we can miss seeing the forest by looking at the trees, proposals as to a general policy toward foundations may be useful at the outset.

What should that policy be? Is there a rationale to guide policy makers? Unfortunately, the controversies that swirled before and during the enactment of the 1969 legislation, led to adoption of an ambivalent national policy toward private foundations. They were sanctioned but taxed. A limit on their life was rejected, but obstacles were erected to their future growth. If foundations do have utility to other institutions in the private service sector, that sector is weakened to the extent that foundation resources are drawn off by government and the flow of new resources cut off. Fundamentally, public policy toward foundations should be guided by concern not just for foundations in their own right but even more for the needs and capabilities of the sorts of agencies and institutions to which foundations provide assistance.

Present policy suggests uncertainty and a "show-me" attitude toward foundations by the Congress. One evidence of this is the creation by the Senate Finance Committee of a Subcommittee on Foundations, which has held several hearings to explore the condition and work of foundations and the effect of the Tax Reform Act on them. Such oversight hearings[85] afford Congress continuing opportunity to assess foundations and to close loopholes, should any appear, through which they might be used to achieve personal rather than charitable ends. Hearings before such committees also permit foundations to outline their work and their continuing efforts to improve performance. Uncertainties about foundations can be explored, and policy issues can be illuminated. Therefore, such scrutiny by Congress is to be welcomed.

Some commentators urge a larger role for government. They propose, for example, that foundations be given some set time in which to become more socially active or to follow some other prescribed course. Others suggest that foundations be regulated as to size, length of life, the composition of their boards, or in other ways that, in the view of the particular observer, will improve their management or more wisely direct the application of their resources.

We reiterate our recommendation that unless foundations should be shown not to be serving genuine needs of the society and in legitimately charitable ways, government should continue to exercise the same restraint toward them that it exercises as to other charitable institutions in matters such as those of board composition, size, life span, the choice of program objectives, and the determination of how to try to reach those objectives. Fiscal abuses and partisan politics ruled out – as they are now in stringent detail – foundations should be accorded the freedom enjoyed by others in the private nonprofit service sector to work toward self-improvement and higher levels of public service.

Phrased more categorically, this recommendation is that as a matter of policy the government should accord foundations, in the absence of specific abuses, equal treatment with other *bona fide* charitable organizations. The Gallup survey cited earlier indicated generally favorable public attitudes toward foundations and a public belief that they serve the public well, foster desirable experimentation, and are a useful supplement to government. If these beliefs accord with fact, public policy should be supportive. The great power of government and its pervasiveness make governmental restraint a virtue in the absence of abuses mandating governmental intervention.

Recommendation 1: Reduce and redesignate the 4 percent excise tax. In the interest of the institutions and persons who are the actual and potential beneficiaries of foundations, it is recommended that the tax be adjusted to the real costs of administering the laws governing foundations and that the proceeds be earmarked for this purpose.

Careful auditing of the foundation field is a proved necessity, and the payment of reasonable fees to meet its costs is unobjectionable. However, any tax on foundations is a violation of a basic principle whereby charitable organizations have been given tax exemption because their resources are devoted to endeavors that serve the public interest. It is therefore recommended that the tax be redesignated an auditing or supervisory fee.

Two lesser suggestions: (1) It would seem more logical to base such a fee on foundation assets rather than on investment income, since the latter base penalizes foundations intent on getting as good investment returns as possible in order to make as large distributions as possible to charities. (2) If net investment income is maintained as the base for computing the fee, it would seem reasonable to exclude long-term capital gains as an income item, since when these are realized by foundations, it is to maintain high levels of giving or to meet other requirements of the law.

Recommendation 2: Adjustment of the level of the required annual pay-out. The current requirement as a percentage of assets ("minimum investment return" in the legislation) should relate more closely to the real rates of return over long periods from funds broadly invested in American capital markets.[86] This suggests an annual requirement set at 5 percent of assets, the rate originally proposed in 1969 by the Treasury and endorsed at that time by both the Ways and Means and Finance Committees. At 6 percent and with the possibility of fluctuating higher, the current MIR is clearly out of line with the apparent purpose of the 1969 act to strike a balance between insuring a substantial current return to charity from foundation holdings and sustaining their capability to provide such returns in the future.[87] Instead, the current MIR compels foundations with well-balanced holdings to invade capital beyond any realistic expectations of long-term capital appreciation to cover such invasions. It thus means gradual, progressive reduction in the support foundations can extend to charitable endeavors.

If a MIR rate adjusted periodically to shifts in the equity and money markets is judged to be preferable, the high degree of volatility in the current formula should be corrected. It should (1) utilize long (five- to ten-year) time-frames for its comparison of relative values, (2) give due weight to total returns on balanced portfolios, (3) employ a 5 percent norm rather than a 6 percent norm.[88] A reasonably steady MIR is important in order to enable foundations to choose sensibly among investment strategies and to make forward grant commitments in a rational manner.

The requirement that all adjusted net income must be paid out annually, if that is higher than the MIR, should be maintained as a protection against pay-out levels dropping excessively when asset values drop – as in 1974.

Beyond these major concerns, the lack of any transition period for new foundations to reach the full pay-out requirement also merits reconsideration. To meet the requirement, some foundations are having to dispose of substantial holdings, and this sometimes poses special difficulties where real estate or the securities of a single company are involved. Forced divestiture on a short time-scale can depress values for both the foundation making the sale and other holders of the same assets. The very uncertain and generally disadvantageous market conditions recently experienced emphasize these problems. Transition rules allowing somewhat more flexibility in these situations to post-1969 foundations, as previously to pre-1969 foundations, could result in long-term gains to charity.

Recommendation 3: Removal of special limitations on gifts to foundations. Now that private foundations have been brought under strict and effective regulation in the conduct of their fiscal affairs and their fidelity to *bona fide* philanthropic purposes is under far closer governmental scrutiny than is that of most so-called public charities, the second- or third-class citizenship accorded foundations with respect to the receipt of gifts makes little sense.[89] We refer here particularly to the 20 percent limit on tax deductions for gifts to private foundations as against those to public charities and to the less favored treatment of gifts of appreciated securities when made to private foundations.

These provisions of the 1969 act are distinct discouragements to the creation of new foundations and the augmentation of existing ones, particularly those of substantial size. It is estimated that there are less than 500 foundations with assets of $10 million or more, and these are largely the ones to which individuals and organizations must turn when major financing is needed for new programs and approaches. Moreover, to obtain support in any one field of work, grant seekers can usually turn to only a handful of these foundations, since they tend to specialize to some extent.

Thus the net effect of these disincentives is to add to the likelihood that foundations will have a declining role in the meeting of significant needs. A consequence will be reduced freedom and flexibility on the part of other nonprofit institutions and in the society generally. For these combined reasons, we recommend that foundations be treated like other *bona fide* charities as to their eligibility to receive tax deductible donations.[90]

Recommendation 4: Adjustments in certain divestiture requirements. These requirements of the 1969 act are also at least partial disincentives to the establishment of new foundations in cases where the control stock of a given company is involved; but with respect to foundations established before 1969, extended transition periods (10-35 years) are provided and the basic provisions of the act seem sound.

(a) *A longer transition period for new foundations:* For foundations established after 1969 and for gifts of control stock received by other foundations after that time, the period allowed for divestiture is only five years. This can be the cause of severe difficulty and loss not only to a potential foundation but to others as well. Change in the law to permit a 10-year transition period on divestiture for post-1969 situations would reduce these problems. It would also remove most of the inequity that now pertains between persons facing the post-1969 requirements as against those who are facing the pre-1969 ones. Such change is therefore recommended.

(b) *Easing of transactions with disqualified persons:* It is fair to assume that foundations will frequently look to disqualified persons in divestiture situations, and the transition rules were developed to permit this. Yet, the rules of the statute and the regulations contain a number of handicaps.[91] One is that after a divestiture to a disqualified person, the IRS can still claim that the purchase price was inadequate and assess a self-dealing tax. There is no advance ruling procedure available to ensure against such a tax. It is submitted that there should be.

In addition, there are certain special, narrow TRA provisions which facilitate divestiture of control stock owned by a private foundation on May 26, 1969, but which are not available with respect to gifts of "excess" holdings received after May 26, 1969.[92] Yet, foundations face the same limited marketability problems regardless of when such stock was received.[93] The same provisions should apply to both new and old holdings, and they should be broad enough to provide a real rather than only an apparent avenue for divestiture.

(c) *Removal of excess business holding taxes for inadvertent purchases:* Finally under section 4943, a private foundation can be taxed because of stock purchases by a disqualified person even though the foundation cannot control such purchases and may not even be aware of them.[94] Although proposed regulations would give some limited divestiture relief in such a situation, it is questionable whether there is sufficient statutory authority for the regulations. The statute should be amended to authorize reasonable divestiture procedures under which such purchases would not subject the foundation to tax.

Recommendation 5: Easing of certain program restrictions.

a. *A floor for expenditure responsibility requirements:* While staffed foundations that wish to make grants to activities and agencies without official tax-exempt status or to private operating foundations have shown that they can meet the expenditure responsibility requirements of such grants, doing so is harder for smaller foundations, and having to do so is a deterrent to risk taking.

We recommend that a ceiling of $5,000 be set below which the aggregate annual grants to one recipient by a foundation would be exempt from the expenditure responsibility requirements of the 1969 act. Such a change would benefit new and inexperienced groups seeking foundation assistance; it would aid privately endowed custodial homes for the young and the aged, museums, and the like, whose own resources are inadequate; it would encourage more venturesome grant making; and it would reduce some of the administrative costs, and hence free more funds, in the case of those foundations that are now making expenditure responsibility grants.

b. *Easing of the rules governing scholarship programs of company foundations:* The IRS has been interpreting the law to mean that company foundation scholarship programs that include children of employees are unacceptable unless no more than 25 percent of the children of employees who apply and meet eligibility requirements are given awards. This is surely an extreme limitation that denies aid to a very high proportion of the eligible group and tends to discourage the very idea of such scholarship programs.

We recommend that the tax status of these scholarship programs should not be determined on any set percentage among eligible beneficiaries – a mere administrative convenience, whether the figure be 25 percent or higher. Rather, each program should be examined and judged on its merits – that is, on its capacity to provide needed aid to deserving students while not becoming a form of compensation for company employees.

Recommendation 6: Against a set term for foundation life. Charities, just like business corporations, can be given perpetual existence at the time they are organized, and the protection afforded by law to their continued existence has deep and strong roots in our jurisprudence. Beyond that, there is probably no compelling reason why any foundation should exist forever, but neither are there compelling reasons for a set term to their lives. The issues are ones to be judged finally in terms of the ability of foundations to continue to be of useful service and of the need for and acceptance of these contributions on the part of the general society.

So long as foundations show a capacity for self-renewal and for sensitive and responsible service over time, their continued existence is at least as justified as that of any other endowed charitable organization. Indeed it is noteworthy that a number of America's oldest grant-making foundations are today among the livelier and more progressive examples of the species: for example, Southern Education Foundation (an outgrowth of the George Peabody Education Fund), Russell Sage Foundation, Carnegie Corporation of New York, Rockefeller Foundation, and the Cleveland Foundation.[95] There are no apparent traces of an inhibiting "dead hand" in any of these. As to the American society's needs for the sorts of free and flexible capital committed to charitable purposes that foundations provide, it seems unlikely that these needs will diminish in the years ahead. Therefore, any legislated requirement that would necessarily reduce the availability of foundations' resources, considered in aggregate, would represent bad policy.

Assuming the absence of legal constraints, whether a given foundation can do the most good by spending itself out of existence or by conserving its capital is, however, a very proper matter for its trustees to consider. It is a question that such boards should consciously weigh and answer for themselves periodically, even as program objectives also should be reexamined and redefined from time to time.

Circumstances do keep changing, and foundations must be responsive to them where possible by conscious choice rather than by drifting. Likewise, these are decisions better left to the responsibility of foundation trustees alert to the shifts of circumstances than foreclosed by legislative fiat.

Recommendation 7: Supervision. Almost all the evidence is that the IRS has sought to conduct in an objective and nonpunitive fashion the enlarged responsibilities imposed on it in 1969 for the oversight of foundations; yet, there are troublesome drawbacks in the assignment there of broad regulatory duties. The basic function of the IRS is tax collection. Consequently, IRS supervision of the exempt organizations is almost bound to have a relatively low status in terms of both staff assignments and policy considerations.

The establishment in the new Pension Reform Act of 1974 of a new Assistant Commissioner for Employee Plans and Exempt Organizations, aided by 20 new super-grade positions, appears to represent a beneficial upgrading of the supervisory function for tax-exempt organizations within the IRS. This new office should help to separate somewhat more distinctly, if not fully, supervision of these various nonprofit organizations from the tax-collecting functions of the IRS, and it may also make easier the recruitment and retention in these duties of high-caliber personnel familiar with philanthropy. The Council on Foundations looks forward to cooperating closely with the new assistant commissioner, as does The Foundation Center, particularly in the area of data retrieval and publication.

Even with this recognition of the importance of exempt organizations, however, it seems unlikely that either the Treasury Department itself or the new office of assistant commissioner within the IRS will assume the responsibility of looking beyond regulations and sanctions to what might better protect, strengthen, and encourage philanthropic activity in the society.[96] Because the function of defending philanthropy and challenging it to heightened performance seem to us to be appropriate elements of national policy, a superior supervisory arrangement would in our view be the establishment of a national commission independent of any existing agency, just as the SEC is independent. Such a commission would have these characteristics:

> responsibility only for the field of charity, not other forms of tax-exempt organizations;
>
> a basis in the assumption that charity serves the public interest and that its supervision should be less punitive than supportive, except in cases of manifest abuse;
>
> a thoroughly objective and fair-minded stance, insulated from partisan politics;
>
> recognition of the basic powers and responsibilities of the states in regard to charities, and effective collaboration with them in the furtherance of common objectives;
>
> leadership and staff composed of individuals with the necessary background and experience to deal competently with the needs and problems of the charitable field.[97]

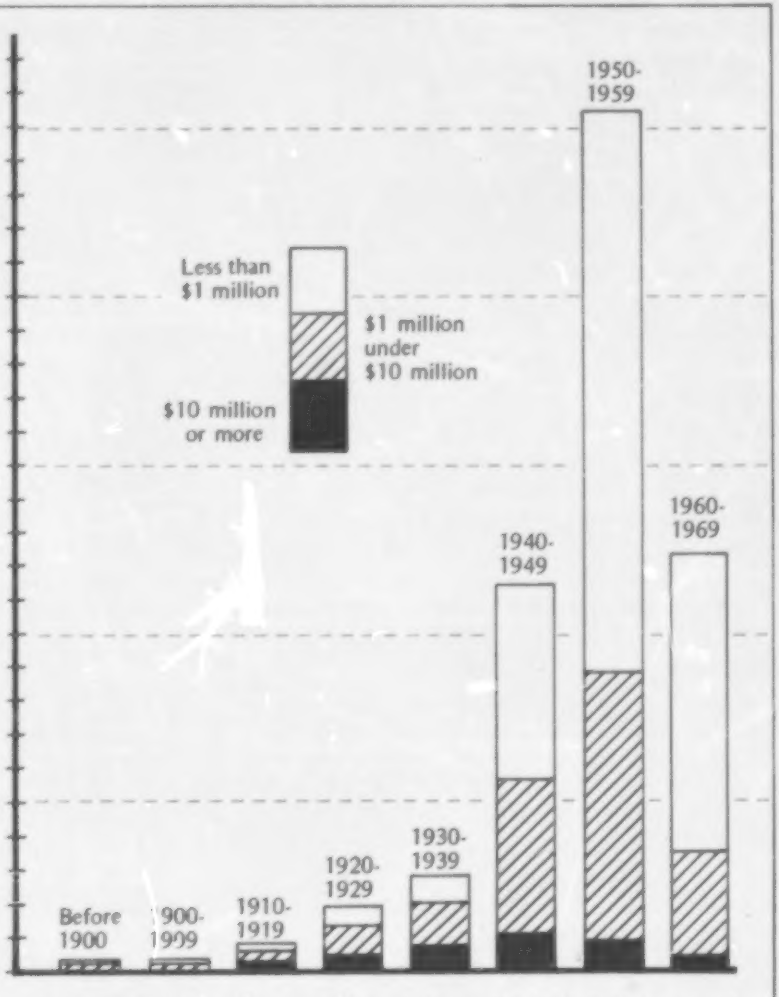
While this listing suggests it, we wish in closing to emphasize our sense that the states should become more alert to and active about the basic powers and responsibilities they have in regard to all forms of charity, including the foundations. States attorneys general are often closer to the situations in which the charities are functioning, and the equity powers of state courts can often be used to bring about corrections more rapidly and with a better eye to the public interest than can the application of federal regulations and sanctions.

Appendix A

GROWTH AND DIMENSIONS OF THE FOUNDATION FIELD

Chart A-1

Period of Establishment of 5,436
Foundations, By Asset Classes



Source: *The Foundation Directory, Edition 4.*, Marianna O. Lewis (Ed.), The Foundation Center (Columbia University Press, 1971).

Table A-1

990 Tax Exemption Letter Year[a]

Year of Tax Exemption Letter	Number of Foundations	Total Assets as of Fiscal Year 1971 (in thousands)
1961	210	$ 285,963
1962	197	273,588
1963	212	1,146,696
1964	336	731,987
1965	233	603,028
1966	206	322,102
1967	177	174,009
1968	180	319,329
1969	167	473,469
1970	229	291,615
1971	155	182,400
1972	45	195,991
Totals	2,347	$4,900,179

Source: The Foundation Center

a. This Table updates CHART 1, but does so on the basis of tax-exemption letter year. As of the end of 1963, organizations were no longer required to operate for one year or more before applying for tax-exempt status. Therefore the exemption letter year could correspond more closely to year of establishment. Information is included for foundations that either made grants of $25,000 or more in the year of record, or possessed assets of $500,000 or more. The year of record is fiscal year 1971 or early fiscal year 1972. It is obvious that the 1960s and early 1970s have witnessed a decline in the new formation of foundations as compared with the growth of the 1950s. Note that detail of assets does not add to total because of rounding, and that 28 community foundations with total assets of $15 million are included in the data.

Table A-2

Assets and Grants For Foundations With Under $1 Million In Assets,[a] By Asset Ranges

Asset Range (in thousands)	Number of Foundations	Total Assets (in thousands)	Total Grants (in thousands)	Number of Grants
0-$50	12,681	$ 176,138	$143,947	152,630
50-100	2,899	209,008	39,314	50,339
100-150	1,651	202,376	28,784	33,578
150-200	1,118	193,702	24,418	22,926
200-250	799	177,909	21,913	19,060
250-300	554	151,240	17,697	13,782
300-350	408	132,136	15,585	10,927
350-400	384	143,810	15,487	10,479
400-450	284	120,536	11,394	7,837
450-500	266	125,902	13,316	6,542
500-550	217	113,821	9,129	6,367
550-600	207	119,285	11,030	6,309
600-650	184	115,510	12,985	5,557
650-700	151	101,565	6,831	4,552
700-750	134	96,8[illegible]8	8,032	3,471
750-800	118	91,594	8,719	3,279
800-850	103	84,916	5,635	2,989
850-900	95	83,250	12,297	2,606
900-950	77	71,232	6,809	2,264
950-1000	91	88,611	6,397	2,046
Totals	22,421	$2,599,410	$419,719	367,540

Source: The Foundation Center

a. Information recorded for foundations having less than $1 million assets in fiscal year 1971 and early fiscal year 1972. Includes information on 60 community foundations with assets of $13.8 million and grants totaling $1.6 million (665 grants).

Table A-3

Assets and Grants For Foundations With Under $1 Million In Assets,[a] By Region and State

Place	Number	Assets (in thousands)	Grants[b] (in thousands)
New England	2,241	$ 253,935	$ 29,718
Maine	78	6,787	753
New Hampshire	158	17,825	1,200
Vermont	31	4,162	165
Massachusetts	1,325	155,954	18,209
Rhode Island	113	14,592	1,886
Connecticut	536	54,615	7,505
Middle Atlantic	6,634	746,308	113,738
New York	4,801	543,188	84,011
New Jersey	651	66,658	8,801
Pennsylvania	1,182	136,462	20,926
East North Central	4,756	542,710	81,650
Ohio	1,255	156,404	21,815
Indiana	422	50,432	6,944
Illinois	1,702	175,015	29,775
Michigan	742	96,208	13,227
Wisconsin	635	64,651	9,889
West North Central	1,610	190,758	26,861
Minnesota	482	64,791	10,869
Iowa	272	25,643	2,872
Missouri	532	65,442	8,416
North Dakota	34	3,621	403
South Dakota	17	1,163	90
Nebraska	130	12,108	1,496
Kansas	143	17,990	2,715
South Atlantic	2,448	303,986	35,083
Delaware	105	15,313	2,214
Maryland	385	45,732	5,668
D. C.	244	27,214	4,135
Virginia	328	36,693	3,817
West Virginia	56	9,445	657
North Carolina	356	49,715	5,771
South Carolina	115	15,150	1,307
Georgia	352	45,269	5,400
Florida	507	59,455	6,114
East South Central	571	57,532	7,442
Kentucky	145	15,333	1,663
Tennessee	229	26,843	3,792
Alabama	120	8,915	1,282
Mississippi	77	6,541	705
West South Central	1,430	164,627	21,035
Arkansas	118	13,502	1,862
Louisiana	181	19,181	2,576
Oklahoma	149	17,733	2,855
Texas	982	114,211	13,742

(Continued)

Table A-3—Cont.

Assets and Grants For Foundations With Under $1 Million In Assets,[a] By Region and State

Place	Number	Assets (in thousands)	Grants[b] (in thousands)
Mountain	558	67,094	6,703
Montana	42	5,344	271
Idaho	31	3,383	292
Wyoming	9	832	86
Colorado	237	28,772	2,978
New Mexico	29	2,240	159
Arizona	98	11,732	1,304
Utah	80	8,701	1,329
Nevada	32	6,090	284
Pacific	2,093	245,383	33,882
Washington	231	29,291	3,162
Oregon	167	23,931	2,734
California	1,633	180,460	27,251
Hawaii	58	10,928	690
Alaska	4	773	45
Outlying Areas			
Virgin Islands	1	2	14
Totals	22,342	$2,572,335	$356,126

Source: The Foundation Center

[a] Information shown for 22,342 foundations that had assets less than $1 million in fiscal year 1971 or early fiscal year 1972, that made grants less than $500,000 in this period, and including some 1,183 that had zero assets or submitted final returns during this period. Information included for 62 community foundations with assets of $13.8 million and grants totalling $1.6 million.

[b] Grants-paid data lacking for 2,423 foundations.

Table A-4

Assets, Gifts Received, and Grants For Foundations With Over $1 Million In Assets,[a] By Region and State

Place	Number	Assets (in thousands)	Gifts Received[b] (in thousands)	Grants[c] (in thousands)
New England	182	$1,072,459	$ 65,914	$ 47,593
Maine	2	4,246	–	144
New Hampshire	8	16,109	39	533
Vermont	2	9,319	451	44
Massachusetts	106	572,816	4,376	24,419
Rhode Island	10	34,095	2,298	2,232
Connecticut	54	435,874	58,750	20,221
Middle Atlantic	780	14,957,317	538,400	749,593
New York	548	10,966,185	152,060	621,152
New Jersey	59	1,609,512	315,408	39,281
Pennsylvania	173	2,381,620	70,932	89,160
East North Central	502	5,513,619	147,305	263,350
Ohio	161	984,023	33,510	61,655
Indiana	37	1,167,373	17,181	26,929
Illinois	157	818,276	28,100	61,600
Michigan	90	2,278,872	55,741	93,261
Wisconsin	57	265,075	12,773	19,905
West North Central	160	1,296,181	43,423	68,054
Minnesota	68	704,761	15,682	30,906
Iowa	17	54,331	980	5,633
Missouri	59	469,156	21,602	28,107
North Dakota	–	–	–	–
South Dakota	1	1,163	2	17
Nebraska	10	49,257	1,701	2,745
Kansas	5	17,513	3,456	646
South Atlantic	255	2,450,301	50,050	184,466
Delaware	28	230,410	2,038	74,830
Maryland	24	97,099	5,032	5,114
D. C.	29	170,945	7,284	7,907
Virginia	24	81,870	2,040	2,989
West Virginia	1	1,507	–	11
North Carolina	46	784,687	7,863	38,011
South Carolina	12	81,526	5,160	3,094
Georgia	57	847,925	8,726	46,130
Florida	34	154,332	11,907	6,480
East South Central	44	250,379	3,235	14,515
Kentucky	9	94,638	855	2,492
Tennessee	21	112,957	1,810	10,228
Alabama	13	40,024	570	1,767
Mississippi	1	2,760	–	28
West South Central	197	1,759,603	50,031	97,530
Arkansas	4	8,560	490	443
Louisiana	20	74,506	1,175	2,759
Oklahoma	26	266,787	4,330	10,462
Texas	147	1,409,750	44,036	83,866

(continued)

Table A-4—Cont.

Assets, Gifts Received, and Grants For Foundations With Over $1 Million In Assets,[a] By Region and State

Place	Number	Assets (in thousands)	Gifts Received[b] (in thousands)	Grants[c] (in thousands)
Mountain	42	351,426	3,966	14,454
Montana	1	2,682	–	487
Idaho	4	5,171	13	624
Wyoming	2	5,611	86	358
Colorado	20	200,948	131	7,945
New Mexico	3	10,834	3,535	121
Arizona	5	15,447	9	217
Utah	6	7,621	192	407
Nevada	1	103,112	–	4,295
Pacific	218	1,302,783	75,406	70,058
Washington	27	84,587	9,578	6,275
Oregon	14	61,143	331	1,916
California	165	1,077,208	64,770	59,084
Hawaii	12	79,845	727	2,783
Outlying Areas				
Puerto Rico	1	8,490	1,529	25
Totals	2,381	$28,962,558	$979,259	$1,509,638

Source: The Foundation Center

a. Information shown for 2,381 foundations that either had assets of $1 million or more in fiscal year 1971 or early fiscal year 1972 or made grants of $500,000 or more in this period. Includes data on 48 community foundations with assets of $780 million, gifts received totalling $82.5 million, and grants totalling $38.5 million.

b. Gifts were reported for 2,078 foundations.

c. Grants-paid data lacking for 58 foundations.

Table A-5

Numbers, Assets, and Grants of Foundations,[a] By Region
(in millions of dollars)

Place	Foundations		Assets		Grants	
	Number	Percent	Amount	Percent	Amount	Percent
United States	24,723	100%	$31,535	100%	$1,866	100%
New England	2,423	10	1,326	4	77	4
Middle Atlantic	7,414	30	15,704	50	863	46
East North Central	5,258	21	6,056	19	345	19
West North Central	1,770	7	1,487	5	95	5
South Atlantic	2,703	11	2,754	9	220	12
East South Central	615	3	308	1	22	1
West South Central	1,627	7	1,924	6	119	6
Mountain	600	2	419	1	21	1
Pacific	2,311	9	1,548	5	104	6
Outlying Areas	2	*	9	*	**	*

Source: The Foundation Center

a. Information shown for 24,723 foundations as of fiscal year 1971 or early fiscal year 1972. Includes data on 110 community foundations with assets totalling $793.8 million and grants totalling $40.1 million.

* Less than 1 percent.

** Less than $1 million.

Table A-6

Grants Reported in *Foundation News*, 1961 Through 1973, By Major Fields[a]

(in millions of dollars)

Fields	1961		1962		1963		1964		1965		1966	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Education	$107	31%	$145	46%	$ 83	26%	$186	33%	$164	25%	$157	24%
International activities	62	17	52	17	82	25	74	13	128	20	141	21
Health	68	19	32	10	35	11	129	23	103	16	62	9
Welfare	43	12	20	6	24	7	44	8	104	16	81	12
Sciences	37	11	45	14	47	14	58	11	60	9	69	11
Humanities	25	7	16	5	48	15	39	7	39	6	117	18
Religion	9	3	5	2	5	2	26	5	51	8	34	5
Totals	$351	100	$316	100	$324	100	$556	100	$649	100	$661	100

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a. Grants of $5,000 or more are recorded for 1973, while grants of $10,000 or more are recorded from 1961-1972. Information comes from the grant listings in *Foundation News*. Initially The Foundation Center gathered grant information from the published reports, press releases, and newspaper clippings of foundations. Later, grant records were kept on the basis of Form 990ARs, and in 1972 the information base changed to voluntary reports by foundations and selected annual reports. Note that detail may not add to totals because of rounding.

(continued)

Table A-6 (Cont.)

Grants Reported in *Foundation News*, 1961 Through 1973, By Major Fields

(in millions of dollars)

1967		1968		1969		1970		1971		1972		1973		Total	
Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
$190	33%	$308	41%	$202	30%	$281	36%	$343	32%	$206	27%	$258	36%	$2631	32%
84	15	93	12	75	11	59	7	106	10	95	12	66	9	1117	14
81	14	77	10	106	16	121	15	156	15	123	16	172	24	1265	15
82	14	74	10	102	15	136	17	174	16	133	18	67	9	1084	13
79	13	106	14	114	17	93	12	111	10	130	17	87	12	1036	13
39	7	73	10	37	5	52	7	103	10	65	8	57	8	710	9
24	4	23	3	41	6	51	6	73	7	17	2	9	2	368	4
$579	100	$753	100	$677	100	$793	100	$1066	100	$769	100	$716	100	$8211	100

Table A-7

Foundation Grants in Education[a]

Areas of Giving	Number of Grants 1972	Number of Grants 1973	Amount of Grants (in thousands) 1972	Amount of Grants (in thousands) 1973	Percent of Total 1972	Percent of Total 1973
Adult education	11	21	$ 784	$ 3,200	1%	1%
Buildings and equipment	228	214	23,216	24,855	11	10
Communications	136	172	27,599	13,614	13	5
Educational associations	137	95	4,501	5,447	2	2
Educational research	133	136	11,769	16,787	6	6
Elementary and secondary education	345	391	15,723	14,257	8	6
Endowment	20	25	9,169	96,334	4	37
Fellowships	36	48	1,432	5,326	1	2
Higher education[b]	653	477	88,681	49,777	43	19
Libraries	75	112	7,023	9,904	3	4
Personnel development	67	114	7,953	10,887	4	4
Scholarships and loans	204	151	7,287	7,137	3	3
Vocational education	28	23	1,238	420	1	1
Totals	2,073	1,979	$206,375	$257,945	100	100

a. Grants reported in *Foundation Grants Index*, Volume 13, 1972, and Volume 14, 1973.

b. The Foundation Center's information base changed in 1972 from keeping grant records on the basis of Form 990ARs, to using selected annual reports and voluntary reports from the foundations. Thus foundation support for higher education did not necessarily drop in 1973. More grants were categorized by specific purpose, e.g., endowment and fellowships, rather than using the more general category "higher education."

Table A-8

Foundation Grants in Health[a]

Areas of Giving	Number of Grants 1972	Number of Grants 1973	Amount of Grants (in thousands) 1972	Amount of Grants (in thousands) 1973	Percent of Total 1972	Percent of Total 1973
Dentistry	25	75	$ 1,407	$ 9,710	1%	6%
Health agencies	76	19	4,420	262	4	1
Hospitals[b]	630	381	57,624	44,915	47	26
Medical care and rehabilitation	263	360	10,668	21,956	9	13
Medical education	272	355	26,281	59,224	21	34
Mental health	211	203	8,503	5,992	7	3
Nursing	85	43	5,467	2,905	4	2
Public health	75	81	8,239	26,791	7	15
Totals	1,637	1,517	$122,609	$171,755	100	100

a. Grants reported in *Foundation Grants Index*, Volume 13, 1972, and Volume 14, 1973.

b. The figures do not necessarily indicate declining of foundation support for hospitals. As previously indicated, due to a change in the way grant records were kept, more grants were categorized in 1973 into specific categories such as "medical education" than in general categories such as "hospitals."

Table A-9

Foundation Grants in International Activities[a]

Areas of Giving	Number of Grants		Amount of Grants (in thousands)		Percent of Total	
	1972	1973	1972	1973	1972	1973
General	7	2	$ 108	$ 17	1%	*
Cultural relations	50	44	4,037	2,171	4	3
Education	214	174	27,559	19,765	29	30
Exchange of persons	17	11	1,249	1,579	1	2
Health and welfare	180	200	17,081	16,477	18	25
International studies	140	103	18,223	8,328	19	13
Peace and international cooperation	44	32	5,965	2,046	6	3
Relief and refugees	22	15	729	863	1	1
Technical assistance	108	75	19,774	14,961	21	23
Totals	782	656	$94,725	$ 66,207	100	100

*Less than 1 percent.

a. Grants reported in *Foundation Grants Index*, Volume 13, 1972, and Volume 14, 1973.

Table A-10

Foundation Grants in Welfare[a]

Areas of Giving	Number of Grants		Amount of Grants (in thousands)		Percent of Total	
	1972	1973	1972	1973	1972	1973
General	2	1	$ 121	$ 67	1%	*
Aged	67	76	1,929	1,756	1	3
Child welfare	232	224	7,579	8,407	6	13
Community Deveopment	228	187	17,418	13, 879	13	21
Community funds	43	113	2,795	6,514	2	10
Delinquency and crime	105	129	33,733[b]	3,003	25	4
Handicapped	147	133	6,342	3,682	5	5
Housing and transportation	111	74	7,085	2,846	5	4
Race relations	191	91	15,115	5,095	11	8
Recreation and conservation	161	101	13,380	3,310	10	5
Social agencies	289	192	7,587	4,129	6	6
Youth agencies	459	485	20,273	13,882	15	21
Totals	2,035	1,806	$133,357	$ 66,570	100	100

*Less than 1 percent.

a. Grants reported in *Foundation Grants Index*, Volume 13, 1972, and Volume 14, 1973.

b. This high total for 1972 is mainly accounted for by a $30-milliion grant by The Ford Foundation toward setting up the Police Foundation.

Table A-11

Foundation Grants in Science and Technology[a]

Areas of Giving	Number of Grants 1972	Number of Grants 1973	Amount of Grants (in thousands) 1972	Amount of Grants (in thousands) 1973	Percent of Total 1972	Percent of Total 1973
General Sciences		6		$ 242		
Physical Sciences						
General	5	1	$ 706	$ 10		
Astronomy and space	12	9	296	246		
Chemistry	85	72	5,842	2,566		
Earth sciences and oceanography	24	19	2,673	6,253		
Mathematics	4	5	227	532		
Physics	44	25	659	318		
Subtotals	174	131	$ 10,403	$ 9,925	9%	11%
Life Sciences						
Environmental studies	133	135	$ 13,741	$ 8,452		
Agriculture	35	36	3,066	2,001		
Biology	74	29	8,656	2,116		
Medical research	295	236	42,593	23,942		
Subtotals	537	436	$ 68,056	$ 36,511	53	42
Social Sciences						
General	9	51	$ 656	$ 2,589		
Anthropology and archaeology	12	10	378	179		
Business and labor	100	80	9,609	4,866		
Economics	26	28	1,589	2,743		
Law	140	184	12,695	9,036		
Political science	95	59	12,328	6,260		
Psychology	49	89	6,190	6,290		
Sociology	55	47	7,436	4,195		
Subtotals	486	548	$ 50,881	$ 36,158	38	42
Technology	21	32	$ 668	$ 4,212	—	5
Totals	1,218	1,153	$130,008	$ 87,048	100	100

a. Grants reported in *Foundation Grants Index*, Volume 13, 1972, and Volume 14, 1973.

Table A-12

Foundation Grants in the Humanities[a]

Areas of Giving	Number of Grants 1972	Number of Grants 1973	Amount of Grants (in thousands) 1972	Amount of Grants (in thousands) 1973	Percent of Total 1972	Percent of Total 1973
General	40	52	$ 1,813	$ 4,928	3%	8%
Art and architecture	122	92	5,704	4,766	9	8
History	74	72	2,415	2,717	4	5
Language and literature	26	17	1,100	1,371	1	2
Museums	164	132	21,464	15,885	33	28
Music	217	145	16,224	8,412	25	15
Other performing arts	188	201	16,066	18,830	25	33
Philosophy	4	4	145	209	*	1
Totals	835	715	$ 64,931	$ 57,118	100	100

*Less than 1 percent.

a. Grants reported in *Foundation Grants Index*, Volume 13, 1972, and Volume 14, 1973.

Table A-13

Foundation Grants in Religion[a]

Areas of Giving	Number of Grants 1972	Number of Grants 1973	Amount of Grants (in thousands) 1972	Amount of Grants (in thousands) 1973	Percent of Total 1972	Percent of Total 1973
General	–	1	–	$ 50	*	1%
Buildings and equipment	27	17	$ 1,077	324	6	4
Churches and temples	63	21	1,505	247	9	3
Religious associations	116	28	4,306	1,440	25	17
Religious education	16	2	609	80	3	1
Religious welfare	91	70	4,717	2,386	27	27
Theological education	81	37	4,884	3,578	28	41
Theology	7	3	324	510	2	6
Totals	401	179	$ 17,422	$ 8,615	100	100

*Less than 1 percent

a. Grants reported in *Foundation Grants Index*, Volume 13, 1972, and Volume 14, 1973.

Table A-14

Estimated Contributions to Philanthropy in the United States from Living Donors, Charitable Bequests, Foundations, and Corporations, by Five-Year Intervals, 1930 to 1970, and 1973

(in millions of dollars)

Year	Gifts of Living Donors	Charitable Bequests	Foundations	Corporation Gifts	Total
1930	$ 931	$ 223	$ 30	$ 10	$ 1,194
1935	715	106	50	10	881
1940	1,068	143	60	38	1,309
1945	2,771	192	75	266	3,304
1950	3,668	206	133	252	4,279
1955	4,789	398	400	415	6,002
1960	7,150	772	650	482	9,054
1965	9,280	1,020	1,130	790	12,220
1970	14,400	2,200	1,900	800	19,300
1973	18,160	3,060	2,360	950	24,530

Sources: Internal Revenue Service; American Association of Fund-Raising Counsel, Inc., *Giving, U.S.A.*; Andrews, *Philanthropic Giving*; The Foundation Center, *The Foundation Directory*.

From F. Emerson Andrews, "Philanthropy in the United States: History and Structure (New York: The Council on Foundations, Inc., 1973), p. 9.

Appendix B

A SURVEY OF THE EFFECTS OF THE 1969 TAX REFORM ACT AMONG PRIVATE FOUNDATIONS CONDUCTED BY THE COUNCIL ON FOUNDATIONS, INC.

FEBRUARY–MARCH 1974

QUESTIONNAIRE TO PRIVATE FOUNDATIONS

This questionnaire is intended to provide factual information for submission to the Commission on Private Philanthropy and Public Needs. The terms used in the questions, such as "operating foundations" and "expenditure responsibility" are intended to have the meanings given them in the Tax Reform Acto of 1969. Where exact figures are unavailable, please use approximations. Note especially that operating foundations should not answer questions 11 through 14. The responses will be used for statistical tabulations, and individual respondents will not be identified.

NAME OF FOUNDATION ____________________ ADDRESS ____________________

FORM COMPLETED BY ____
(Name and Title)

1. Is the foundation _______ operating or _______ non-operating?

2. Please fill in the following totals describing the foundation:

   a. Market value of assets as of 12/31/73: $ ______________

   b. Grants and expenditures on direct charitable activities made during your last tax year (excluding administrative costs): $ ______________

   c. All administrative costs for your last tax year (including legal, accounting, and investment expenses, but excluding 4% tax): $ ______________

   d. Gifts received during your last tax year,
      by bequests: $ ______________
      inter vivos gifts: $ ______________

3. a. Does the foundation have a policy against making expenditures responsibility grants?

   ____ Yes ____ No

   b. If "No", and such grants have actually been made, what was the approximate percentage of expenditure responsibility grants to total dollar value of grants as of:

   Your 1970 tax year _____ % your last tax year _____ %

4. Before the Tax Reform Act did the foundation make the type of grants which would require expenditure responsibility under the 1969 Act?

   ____ Yes ____ No

5. Does the foundation make grants to individuals for travel, study, or similar purposes?

   ____ Frequently ____ Occasionally ____ Never

6. Did the foundation make such grants to individuals before 1970?

   ____ Frequently ____ Occasionally ____ Never

7. Does the foundation *publish* an annual report? ____ Yes ____ No

8. Does the foundation publicize its grants in any other ways?

Please describe the ways: ____ Yes ____ No

____

____

____

9. Does the foundation normally encourage grant recipients to publicize grants?

____ Yes ____ No

10. In 1973, approximately how many people asked to see your most recent 990AR?

________ persons

OPERATING FOUNDATIONS PLEASE OMIT QUESTIONS 11 THROUGH 14

11. In your last tax year, was the foundation's minimum investment return greater than its adjusted net income?

____ Yes ____ No

12. a. Has the foundation's annual payout for charitable purposes incresed since 1969?

____ Yes ____ No

b. If "Yes", how much more did the foundation spend in its last tax year than in 1969?

$ ____________

c. Approximately what percentage of the increase was due to the requirements of the 1969 Act?

________ ___ %

13. Is the foundation experiencing any valuation problems in applying the minimum investment return rule?

Please describe the problems: ____ Yes ____ No

14. Has the foundation revised its investment practices since the 1969 Act?

____ No ____ Yes. Were these a result of the 1969 Act?

____ Yes ____ No

If "Yes", please summarize the revisions:

____

____

15. Does the foundation have excess business holdings which must eventually be disposed of under the 1969 rules?

____ No ____ Yes. What plans has the foundation for disposition? ______________

	1972	1973
Market value of such holdings as of Dec. 31	$ ________	$ ________
Total dividend or other return on such holdings	$ ________	$ ________

16. Please fill in the following:

	1968 tax year	Last tax year	Approximate % of change attributable to 1969 Act
a. Total legal & accounting fees	$ ________	$ ________	________ %
b. Other administrative expenses	$ ________	$ ________	________ %
c. Number of executive staff	________	________	________ %
d. Number of others on payroll	________	________	________ %

17. How many IRS audits has the foundation had since 1969? # ________ audits

18. How many time was spent by IRS agent(s) on each audit? # ________ days

19. Did the agent(s) seem knowledgeable in foundation law and practice?

____ Yes ____ No

20. Did the IRS make any efforts to influence the direction of the foundation's grant-making activities?

____ Yes ____ No

In what ways?

____

____

21. What do you personally think about the following recommendations concerning the 1969 Act? (Check one column for each letter)

	Agree	Disagree	Uncertain
a. The 4% tax should be eliminated	________	________	________
b. The 4% tax should be redesignated as an auditing fee set in accordance with actual IRS costs	________	________	________
c. The level of the payout requirement should be reduced	________	________	________
d. Restrictions on inter vivos gifts to private non-operating foundations ahould be eliminated	________	________	________

22. The 1969 Act sets the basic pyaout rate at 6%, with provisions for transition periods and adjustments to reflect market conditions. What percentage do you think is a reasonable basic payout rate?

________ %

23. Please list further comments, including recommendations for changes in the 1969 Act provisions affecting foundations: ____

____

____

____

Please mail the questionnaire by *April 1st* to:

Council on Foundations, Inc.
888 Seventh Avenue
New York, New York 10019

Exhibit 1

POPULATION OF THE STUDY

Some foundations became members of The Council on Foundations after March 20, 1974, but were not listed as members for purposes of this survey. Community foundations and corporate contributors were also excluded from the list of council members eligible to respond, leaving a total of 547 council members eligible to be included in the survey results.

Council members		685
Less corporate contributors	25	
Less community foundations	113	138
Council members eligible to respond		547

(Includes 76 company foundations and 98 foundations with assets under $1 million)

Information on all private foundations with assets of over $1 million was drawn from the up-to-date mailing lists of The Foundation Center. A total of 1,1701 private foundations with assets of over $1 million (excluding members of the Council on Foundations) were included in the survey population.

Non-council members		
$1 - 4.9 million assets	1263	
$5 - 9.9 million assets	228	
$10 - 25 million assets	141	
Over $25 million assets	79	1711
Less 10 terminations		10
Non-council members eligible to respond		1701

(Includes 210 company foundations)

The response to the council's questionnaire was reasonably good, given the short time period allowed for reply in order to meet the deadline for this report to the Filer Commission. The four-page questionnaire was completed and returned before May 1st by 572 foundations — an overall response rate of 25 percent. Understandably, the response from council member foundations was much better than the average, since they had been informed through our various publications of the creation of the commission and were accustomed to providing the council with various types of information. The response from our own members was 65 percent, as contrasted with 13 percent from non-members to whom the questionnarie was sent.

Within the population responding to the questionnaire, the geographical spread followed that of the know distribution of foundation assets across the country: e.g., response was strongest from the Middle Atlantic and East North Central regions.

REGIONAL GROUPINGS

New England
- Maine
- New Hampshire
- Vermont
- Massachusetts
- Rhode Island
- Connecticut

West North Central
- Minnesota
- Iowa
- Missouri
- North Dakota
- South Dakota
- Nebraska
- Kansas

East South Central
- Kentucky
- Tennessee
- Alabama
- Mississippi

Exhibit 1 (Cont.)

Middle Atlantic
- New York
- New Jersey
- Pennsylvania

South Atlantic
- Delaware
- Maryland
- District of Columbia
- Virginia
- West Virginia
- North Carolina
- South Carolina
- Georgia
- Florida

West South Central
- Arkansas
- Louisiana
- Oklahoma
- Texas

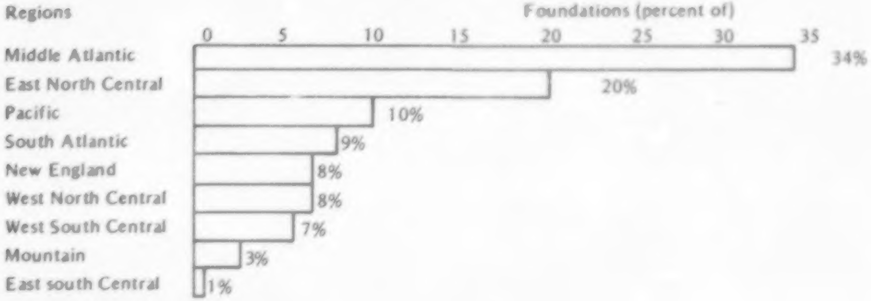
East North Central
- Ohio
- Indiana
- Illinois
- Michigan
- Wisconsin

Pacific
- Washington
- Oregon
- California
- Alaska
- Hawaii

Mountain
- Montana
- Idaho
- Wyoming
- Colorado
- New Mexico
- Arizona
- Utah
- Nevada

REGIONAL LOCATION OF RESPONDENTS

N = 571 foundations



STATE LOCATION OF RESPONDENTS

N = 571 foundations

States	Percent
Alabama	.3
Arizona	.3
Arkansas	.2
California	7.6
Colorado	1.0
Connecticut	3.5
Delaware	1.0
District of Columbia	1.4
Florida	1.0
Georgia	2.3
Hawaii	.7
Idaho	.2
Illinois	6.1

Exhibit I (Cont.)

States	Percent
Indiana	1.7
Iowa	1.0
Kansas	.3
Kentucky	.2
Louisiana	.7
Maine	.2
Maryland	.6
Massachusetts	4.0
Michigan	5.6
Minnesota	4.6
Missouri	1.6
Nevada	.2
New Hampshire	.2
New Jersey	3.3
New York	24.5
North Carolina	1.2
Ohio	4.5
Oklahoma	.9
Oregon	1.0
Pennsylvania	6.6
Rhode Island	.2
South Carolina	.5
Tennessee	.5
Texas	5.8
Utah	.7
Virginia	.3
Washington	1.4
West Virginia	.2
Wisconsin	1.7
Wyoming	.2
	100

TYPE OF RESPONDENTS

Within the responding organizations there is a good cross-section by type—private operating, private non-operating; large, medium, and small; and independent and company related. Community foundations, while an important component of the whole foundation field and of the council's membership, were not asked to respond to this questionnaire, since they are categorized as publicly supported organizations and face few of the regulations affecting "private" foundations.

Of the 286 company foundations eligible to respond, 63 foundatons, or 22 percent of those eligible, returned questionnaires.

Of the 1,962 non-company foundations eligible to respond, 508 foundations, or 26 percent of those eligible, returned questionnaires.

Accordingly, the sample is more highly representative of non-company foundations.

Percent	Foundation Classification	N = 571 foundations
11	Company foundation	
89	Non-company foundation	
100		

Exhibit 1 (Cont.)

Ninety-one foundations responding to the survey were "operating foundations," while the majority were "non-operating foundations."

Percent	Foundation Classification	N = 566 foundations
16	Operating foundation	
84	Non-operating foundation	
100		

Ten foundations were both company and operating foundations.

Exhibit 2

TAX ON INVESTMENT INCOME

Percent	The 4% tax should be eliminated
75	Agree
14	Disagree
11	Uncertain
100	

N = 524 respondents

Percent	The 4% tax should be redesignated as an auditing fee set in accordance with actual IRS costs
72	Agree
17	Disagree
11	Uncertain
100	

N = 516 respondents

Exhibit 3

FOUNDATION REPORTING

Percent	
40	Publish an annual report
60	Do not publish an annual report
100	

N = 566 respondents

Percent	
43	Publicize grants in other ways
57	Do not publicize grants in other ways
100	

N = 563 respondents

Percent	
28	Encourage grant recipients to publicize grants
72	Do not encourage grant recipients to publicize grants
100	

N = 557 respondents

Exhibit 4

REVISIONS IN INVESTMENT PRACTICES

Percent	
53	Minimum investment return was greater than adjusted net income in last tax year
47	Minimum investment return was less than adjusted net income in last tax year
100	

N = 447 respondents

Percent	Revisions in Investment Practices
39	Revised investment practices since the 1969 Act
61	Did not revise investment practices since the 1969 Act
100	

N = 465 respondents

Percent	Reason for Revisions of Investment Practices
77	Revised investment practices as a result of the 1969 Act
23	Revised investment practices, but *not* as a result of the 1969 Act
100	

N = 181 respondents

Percent	Revisions in Investment Practices as a Result of the 1969 Act
1	No longer make mortgage loans
21	Increased investment in bonds
29	Shift from low yield growth investments to higher income-producing securities
8	Diversification by sales and/or stock exchange
6	More emphasis on fixed-income securities
3	Disposed of stock representing excess business holdings/avoid adding it
8	Invest for total return
8	Employed professional investment counsel
15	Other revisions
100	

N = 134 respondents

Exhibit 5

DIFFICULTIES WITH VALUATION PROCEDURES

Percent	Foundation Valuation Problems
21	Experiencing valuation problems in applying the minimum investment return rule
79	Not experiencing valuation problems in applying the minimum investment return rule
100	

N = 458 respondents

Of the 98 foundations stating that they were experiencing valuation problems, 93 listed problems that could be categorized as follows:

Exhibit 5 (Cont.)

Percent	Valuation Problems in Applying Minimum Investment Return Rule
15	Real estate valuation problems
8	Valuation of cash assets is a problem
3	Assets other than securities cause problems
15	Costly and time-consuming bookkeeping and appraisals
18	Problems with securities with readily available prices
27	Problems with securities for which prices are not readily available
8	Real estate valuation problems *and* problems with securities with readily available prices
4	Costly appraisals *and* problems with securities with readily available prices
2	Valuation of cash assets *and* assets other than securities
100	N = 93 respondents

Exhibit 6

THE PAY-OUT REQUIREMENT

Percent	Reasonable Pay-out Rate (%)
2	1 - 2.8
6	3
3	3.5 - 3.8
29	4
14	4.3 - 4.8
19	5
2	5.5 - 5.8
15	6
1	6.5 - 8.5
9	Other (including no set rate)
100	

Average = 5%
Median = 5%

N = 466 respondents

Exhibit 7

RESTRICTIONS ON PROGRAM

Percent	Frequency of Foundation Grant Making to Individuals for Travel, Study, or Similar Purposes Before 1970
10	Frequently
22	Occasionally
68	Never
100	N = 555 respondents

Percent	Frequency of Foundation Grant Making to Individuals for Travel, Study, or Similar Purposes - 1974
8	Frequently
11	Occasionally
81	Never

N = 460 respondents

Exhibit 8

RESTRICTIONS ON PROGRAM

Percent	Foundations that Made the Type of Grants before the Tax Reform Act that would Require Expenditure Responsibility Under the 1969 Act
61	Did not make such grants
39	Made such grants
100	N = 524 respondents

Percent	Approximate percentage of expenditure responsibility grants to total dollar value of grants as of foundation's 1970 tax year
25	Less than 4%
19	4% - 9%
14	10% - 19%
19	20% - 49%
23	50% and over
100	N = 85 respondents

Percent	Approximate percentage of expenditure responsibility grants to total dollar value of grants as of foundation's last tax year
31	Less than 4%
17	4% - 9%
19	10% - 19%
17	20% - 49%
16	50% and over
100	N = 107 respondents

Exhibit 9

EXCESS BUSINESS HOLDINGS

Percent	Foundation Excess Business Holdings
13	Have excess business holdings which must be disposed of under the 1969 rules
87	Do not have excess business holdings which must be disposed of under the 1969 rules
100	N = 565 respondents

Percent	Plans for Disposition of Excess Business Holdings
58	No plans at present/studying the problem
10	Sale of holdings to the company
19	Public offering
4	Orderly reduction of holdings in normal course of business
6	Gift to public charity
3	Liquidate foundation
100	N = 73 respondents

Exhibit 10

AUDIT EXPERIENCE

Percent	
84	Agent(s) seemed knowledgeable in foundation law and practice
16	Agent(s) did not seem knowledgeable in foundation law and practice
100	N = 489 respondents

Percent	
4	IRS made efforts to influence the direction of the foundation's grant-making activities
96	IRS did not make efforts to influence the direction of the foundation's grant-making activities
100	N = 530 respondents

Percent	IRS Efforts to Influence Grant–making Activities
9	Made favorable comments on performance
9	discouraged method of grant distribution in one area
22	Encouraged foundation to avoid expenditure responsibility grants
26	Provided general guidance
4	Advised adjustment of policies regarding relatives of foundation employees
4	Questioned projects for minorities
4	Disallowance of a pension
22	Discouraged scholarships as carried out
100	N = 21 respondents

Exhibit 11

DEATH-RATE AND BIRTH-RATE EVIDENCE

(Excerpted from written testimony of John G. Simon presented in *Hearings Before the Subcommittee on Foundations, Committee on Finance, United States Senate, October 1 and 2, 1973*, pp. 174-175.)

Death-Rate Evidence

As for deaths, we have these clues:

(a) Each month the Internal Revenue Bulletins announce exempt organizations which "have terminated their existence or, for other reasons, no longer qualify as organizations [eligible to receive deductable contributions]." (IRS discontinued announcements as to terminations in September, 1973.) The Council on Foundations has examined the bulletins for a sample month (May) since 1968 (the Tax Reform Act was enacted in December 1969), and finds the following numbers of terminating organizations that appear to have been private foundations:

May, 1968	11	May, 1971	31
May, 1969	23	May, 1972	55
May, 1970	29	May, 1973	74

(b) The New York State Attorney General's Office reported to an American Bar Association committee in 1972 that in 1969, 1970 and 1971 the following numbers of private foundations had dissolved with the consent of that office:

1969	28	1971	91
1970	76		

Exhibit 11 (Cont.)

(c) Charles W. Rumph, Assistant Attorney General of California, reported to the Subcommittee on Domestic Finance of the House Committee on Banking and Currency, in April 1973, that "[p]rivate foundations are being dissolved at a rate nearly double what it was prior to the [Tax Reform] Act."

(d) The Council on Foundations, basing its information on monthly Internal Revenue Bulletin termination announcements, estimates that there were approximately 624 foundations included in the terminations reported during the first eight months of 1973.

(e) Twenty community foundations have reported to the Council on Foundations that between January 1, 1970 and the summer of 1973, they received the assets of 91 dissolving private foundations; the transferred assets had a market value in excess of $60 million.

(f) A report by The Conference Board, "The Impact of the Tax Reform Act of 1969 on Company Foundations," states that 24 out of 240 company foundations "have either been terminated or are in the process of being phased out."

Birth-Rate Evidence

The birth rate phenomenon has two components: formation of new foundations and the addition of capital to existing, not-fully-funded foundations. With respect to the first point, the following evidence strongly suggests a reduced rate of formation:

(a) The Council on Foundations has counted the number of "new organizations" which appear to be private foundations and which are listed in two supplements to the I.R.S. Cumulative List of Organizations—Supplement 1969-1 (Jan.-Feb. 1969), published prior to the Tax Reform Act, and Supplement 1973-1 (Jan.-Feb. 1973), published three years after the passage of the Act. The results:

Jan.-Feb. 1969 Supplement: 433 new private foundations.
Jan.-Feb. 1973 Supplement: 181 new private foundations.

(Even the January-February 1973 figure of 181 foundations may be misleadingly large. Many of these organizations may have been created prior to passage of the Act but were only recently added to the Cumulative List because of the notice provisions of Code Section 508 and other factors. Other foundations among the list of 181 may have been formed after passage of the Act but in accordance with provisions contained in wills executed, or trusts created, prior to passage, i.e., provisions not affected by the Act.)

(b) On April 24, 1972, the Committee on Charitable Trusts of the American Bar Association's Section on Real Property, Probate and Trust Law reported, on the basis of a survey of 90 law firms in New York State and reports from other states, that "[b]ecause of the burdens of the Tax Reform Act, there has been a marked slowdown in the establishment of new private foundations."

(c) In a survey published last January in TAXES magazine, 13 lawyers and accountants representing 256 private foundations stated that they would have recommended formation of only one quarter of these foundations had the Tax Reform Act been in effect at the time of creation. Twelve of these advisors also reported that they had in fact recommended the formation of 17 foundations since passage of the Act, compared to the 36 they would have recommended if there had been no change in the law.

On the second aspect of birth rate, contribution of new capital to existing foundations, the available information is quite spotty. But once again there are clues:

(a) The Council on Foundations has examined two random samples of 100 foundations with assets of more than $5 million. The first sample of 100 foundations was examined for gifts received in accounting years ending before January 1, 1970; the second sample of 100 foundations was examined for gifts received in accounting years beginning after December 31, 1969. The examination showed that:

Exhibit 11 (Cont.)

> Forty-two foundations in the first group received gifts in 1967, 1968 or 1969, totaling in value $37 million; 29 foundations in the second group received gifts in 1970 or 1971, totaling in value $35 million.

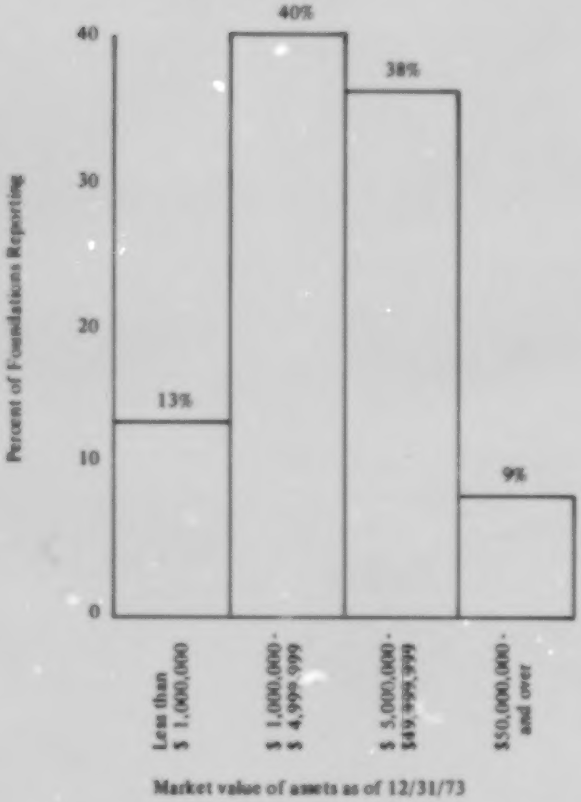
This comparison probably does not begin to measure the full impact of the Tax Reform Act on gifts to existing foundations, for many of the gifts received by the second group of foundations appear quite clearly to have been made under wills executed or trusts created prior to the passage of the Act; in other words, if only gifts under post-Act instruments were counted in the second group, the drop-off would be much more marked. (Unfortunately, one cannot always tell from the information returns whether or not a gift received by a foundation was made under a pre-Tax Reform Act instrument.)

(b) The Conference Board's report in the impact of the Tax Reform Act states that "there is abundant evidence that gifts of appreciated property to company foundations have been either cut back sharply or eliminated and there is no reason to expect any change in this situation."

Figure B-1

Total Market Value of Assets

(566 foundations reported total assets of $17,383,329,122)



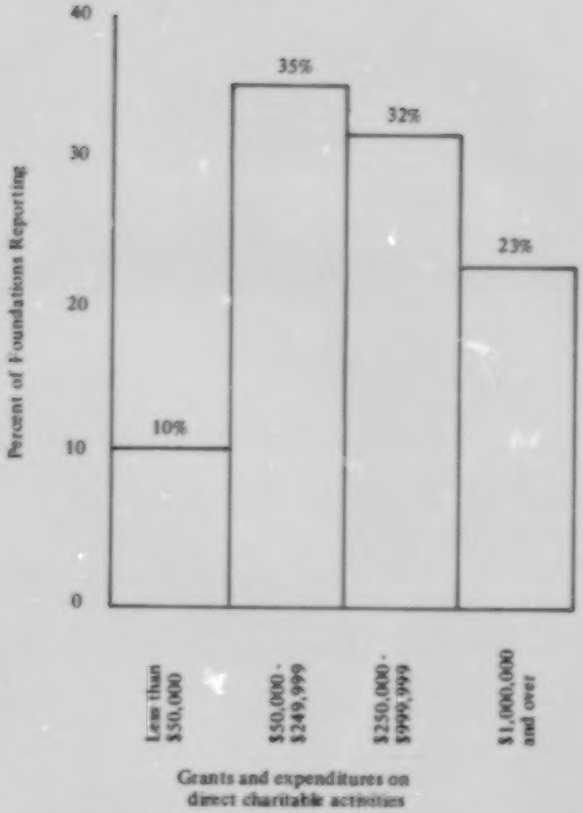
Average assets = $30,712,596
Minimum assets recorded = $4,463
Maximum assets recorded = $2,838,110,000
Median for assets recorded = $4,361,728

FIGURE 1 shows the spread by size of assets among the responding foundations. The total market value of assets reported by all respondent foundations was over $17,000,000,000, representing 63 percent of the total assets for the entire field, as estimated by the American Association of Fund-Raising Counsel, in *Giving USA*, 1974, p. 14.

Figure B-2

Total Grants and Expenditures on Direct Charitable Activities

(567 foundations reported total grants
and expenditures of $967,668,764)



Average grants = $1,706,647
Minimum grants recorded = $4,970
Maximum grants recorded = $226,048,000
Median for grants recorded = $293,880

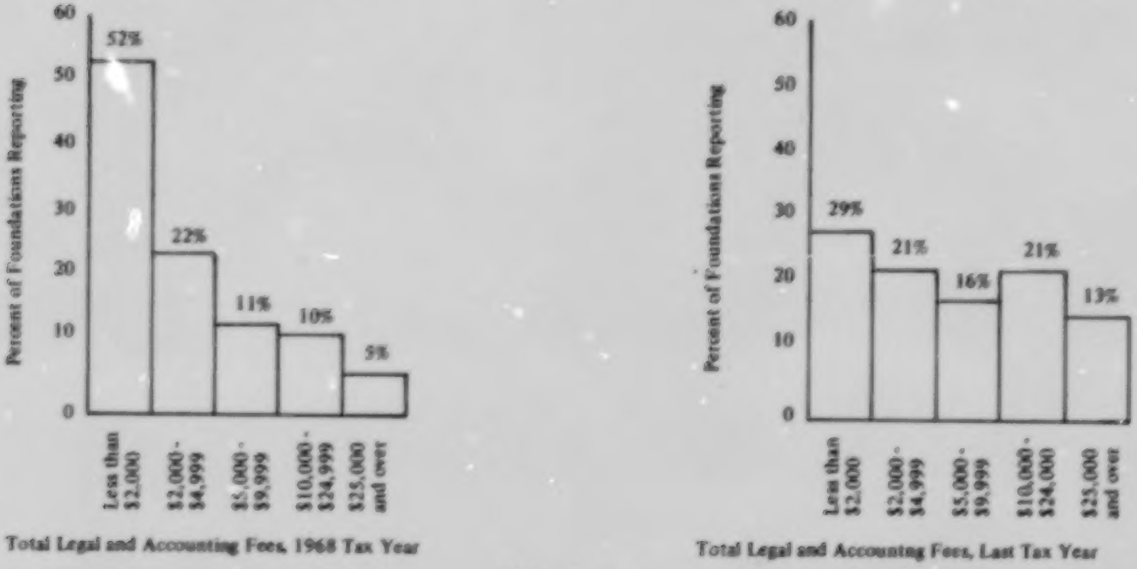
While size of assets is one useful way of measuring foundations, their impact on society, and particularly the nonprofit sector, is better measured by figures covering grants and direct expenditures on charitable activities. The respondents to the council questionnaire show total grants and expenditures of $967,000,000 for their most recent tax year, or approximately half of the estimated $2,000,000,000 plus expended by all foundatons in 1973 (as reported by American Association of Fund-Raising Counsel in *Giving USA*, 1974, p. 13).

Figure B-3

Total Legal and Accounting Fees, 1968 and Last Tax Year

(360 foundations reported total fees of $2,977,924 for 1968 tax year)

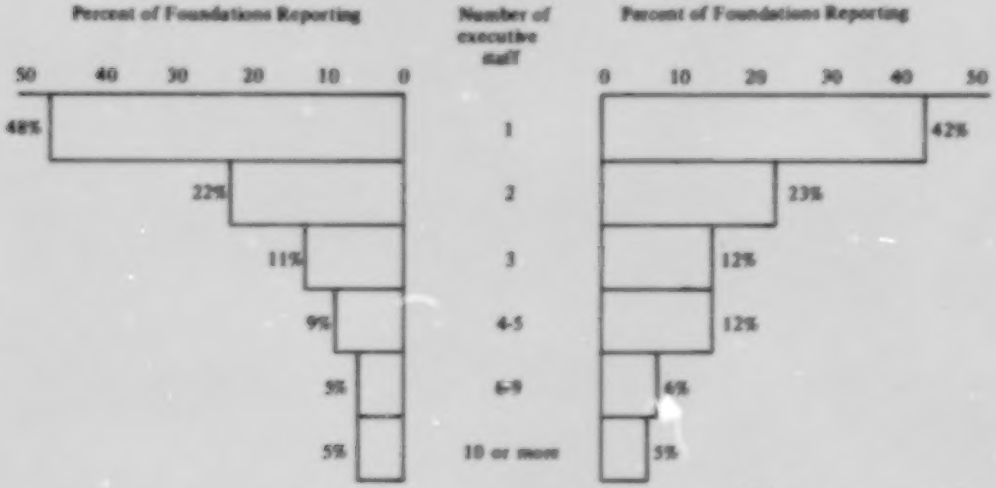
(433 foundations reported total fees of $6,332,635 for last tax year)



	1968 tax year	Last Tax year
Average legal and accounting fees	$ 8,272	$ 14,625
Minimum legal and accounting fees recorded	2	4
Maximum legal and accounting fees recorded	530,947	805,590
Median legal and accounting fees recorded	1,813	4,880

Figure B-6

Total Executive Staff, 1968 and Last Tax Year



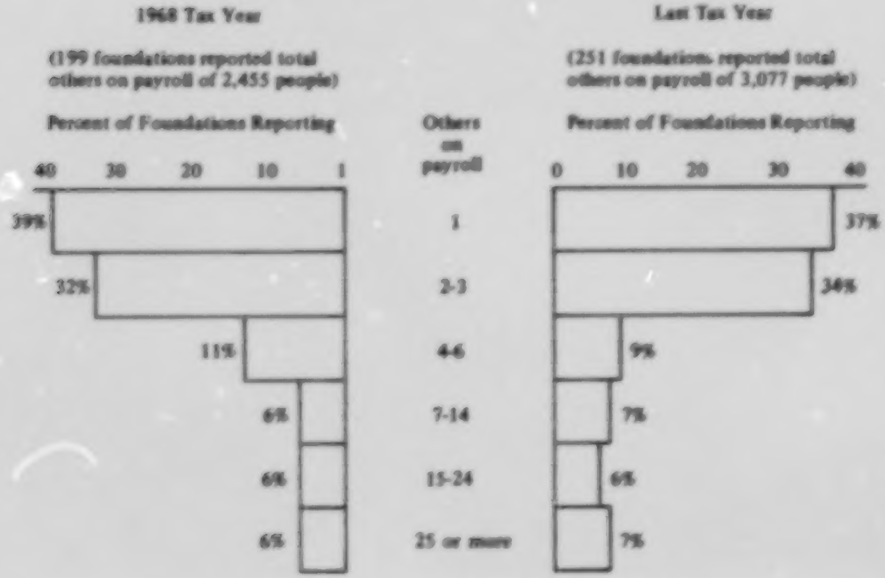
1968 Tax Year
(304 foundations reported total executive staff of 785 people)

Last Tax Year
(350 foundations reported total executive staff of 977 people)

	1968 tax year	Last tax year
Average number of executive staff	3	3
Minimum executive staff recorded	1	1
Maximum executive staff recorded	17	17
Percentage of respondents listing no staff	47%	39%
Median for executive staff recorded	2	2

Figure B-6

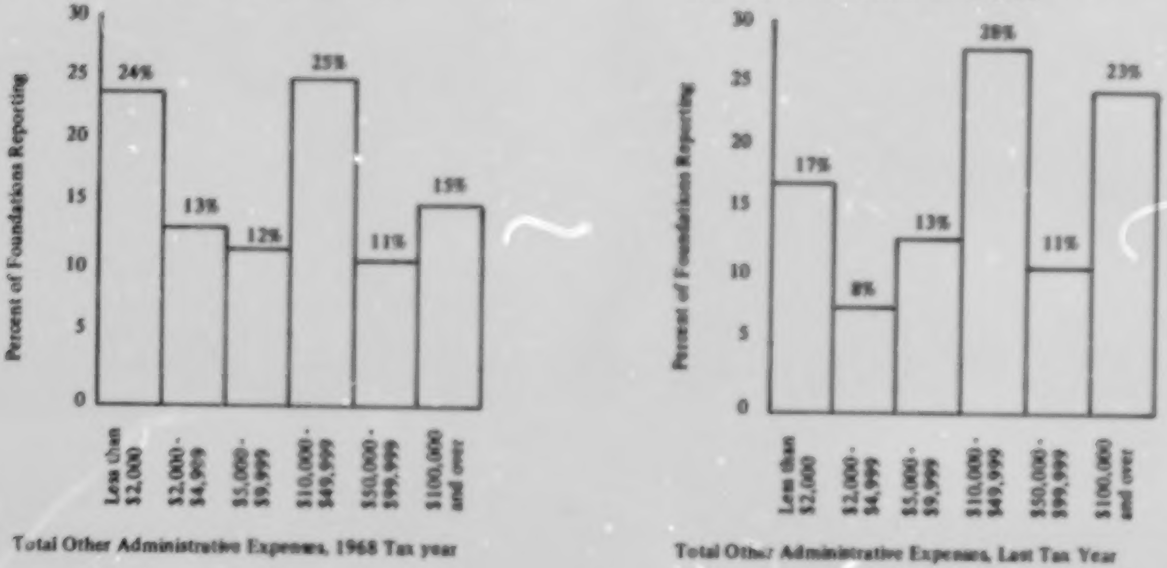
Total Number of Others on Payroll, 1968 and Last Tax Year



	1968 tax year	Last tax year
Average number of others on payroll	12	12
Minimum number of others on payroll recorded	1	1
Maximum number of others on payroll recorded	530	627
Percentage of respondents listing no others on the payroll	65%	56%
Median for number of others on the payroll	2	2

Figure B-4

Total Other Administrative Expenses, 1968 and Last Tax year



(399 foundations reported total other administrative expenses of $36,187,056 for 1968 tax year)

(466 foundations reported total other administrative expenses of $60,065,180 for last tax year)

	1968 tax year	Last tax year
Average other administrative expenses	$ 90,694	$ 128,895
Minimum other administrative expenses recorded	1	3
Maximum other administrative expenses recorded	7,317,105	8,799,137
Median other administrative expenses recorded	10,373	20,047

Figure B-7

Total Number of People Asking to See 990ARs

(570 foundations reported total of 3,193 people)

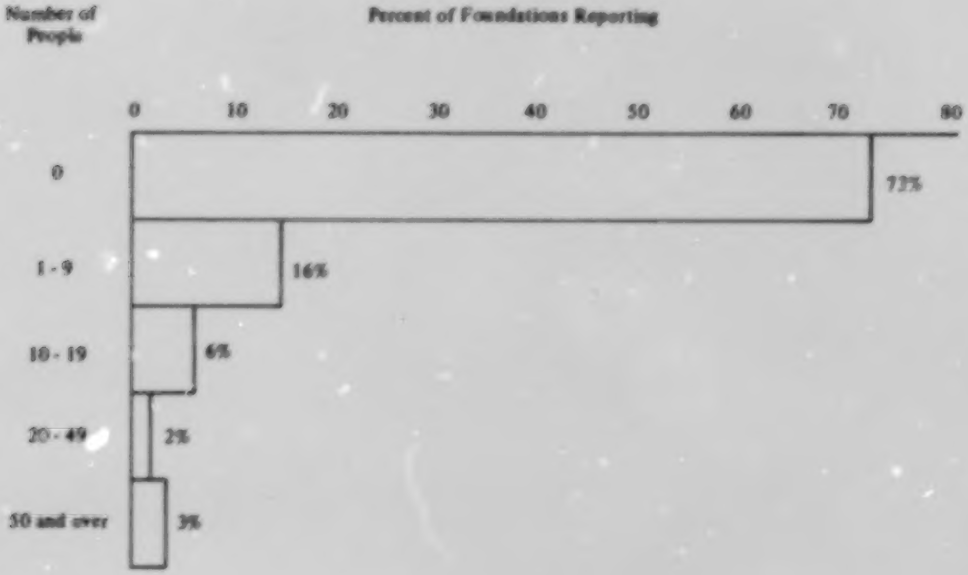
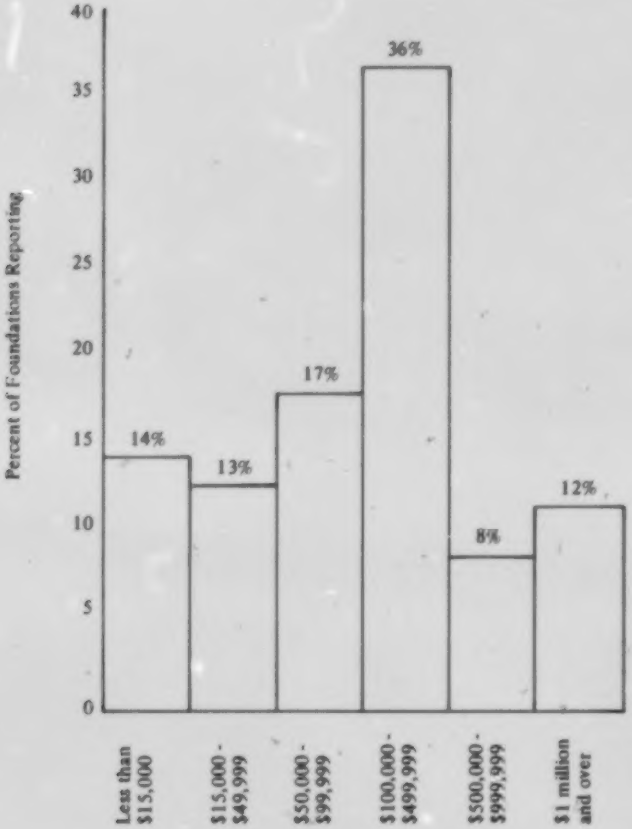


Figure B-8

Pay-Out: Total Amount More That Foundations Contributed In Last Tax Year Than In 1969

(Of 455 respondents, 75 percent reported annual pay-out for charitable purposes has increased since 1969 and 25 percent reported it has not increased.)

(293 foundations reported a total pay-out increase of $210,398,995.)

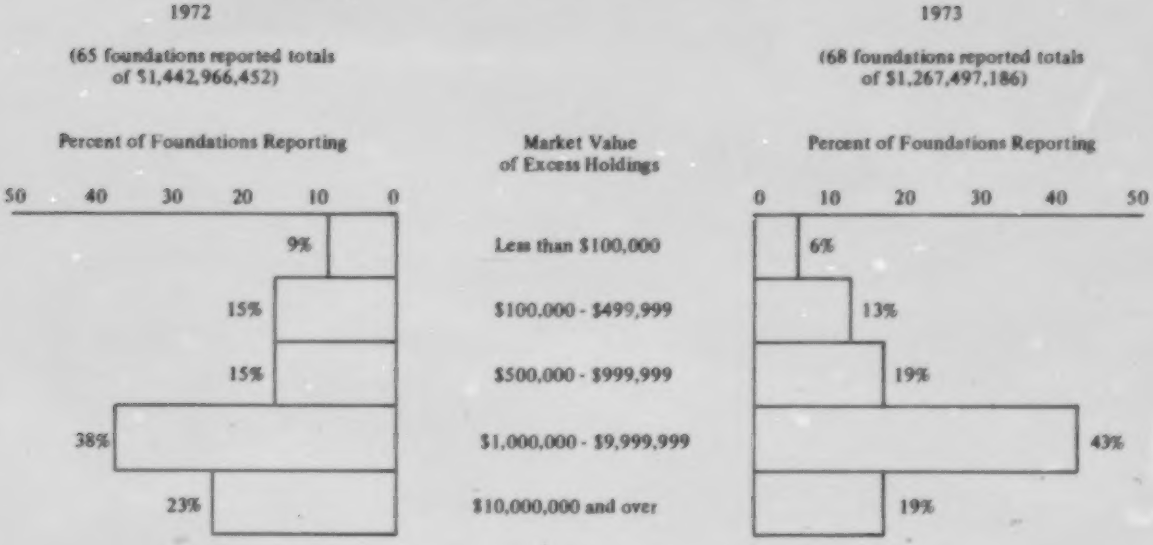


Total amount more that foundations contributed in last tax year than in 1969.

Average pay-out increase = $718,085
Minimum pay-out increase recorded = $20
Maximum pay-out increase recorded = $25,438,000
Median for pay-out increases recorded = $120,517

Figure B-9

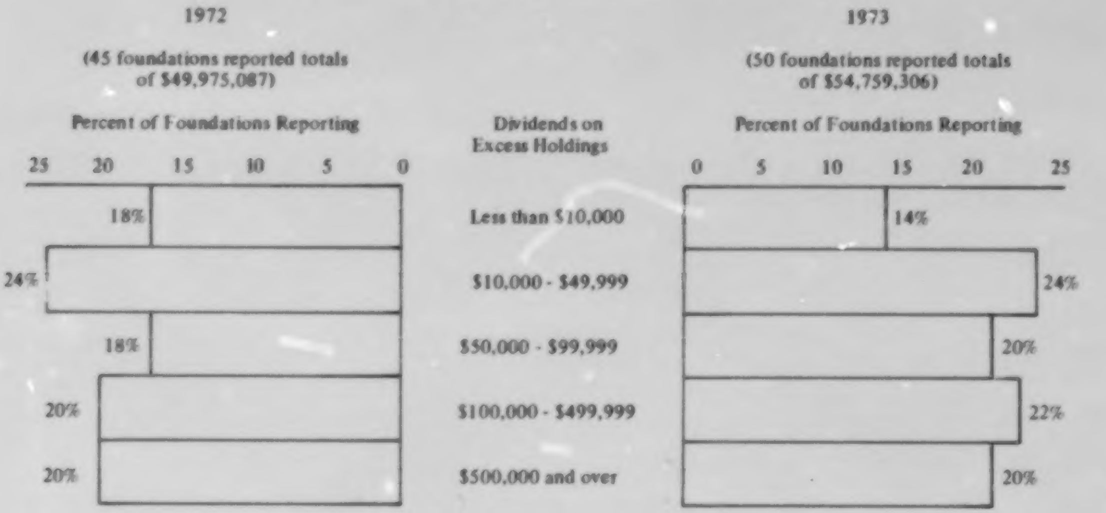
Total 1972 and 1973 Market Value of Excess Business Holdings



	1972	1973
Average value of excess holdings	$ 22,199,480	$ 18,639,665
Minimum recorded	1,993	2,400
Maximum recorded	441,000,000	529,000,000
Median	1,785,257	1,770,000

Figure B-10

Total 1972 and 1973 Dividends or Other Returns On Excess Business Holdings

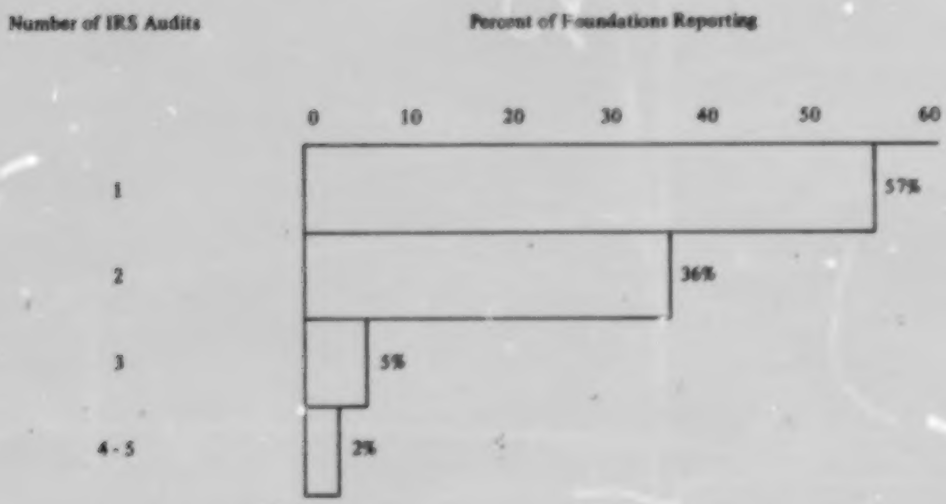


	1972	1973
Average dividends on excess holdings	$ 768,847	$ 805,284
Minimum dividends recorded	527	527
Maximum dividends recorded	18,249,140	19,500,000
Number of foundations with excess holdings reporting no dividends	20	18

Figure B-11

IRS Audits

(512 foundations reported a total of 782 audits since 1969)

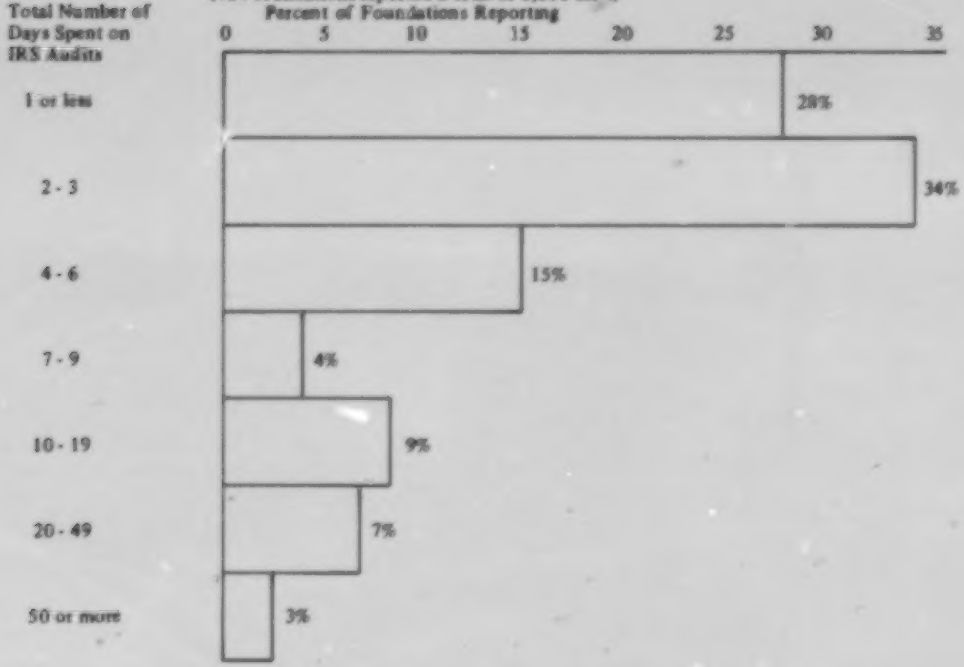


Average number of IRS audits = 2 audits/foundations.

Figure B-12

Total Number of Days Spent By IRS Agents On Foundation Audits

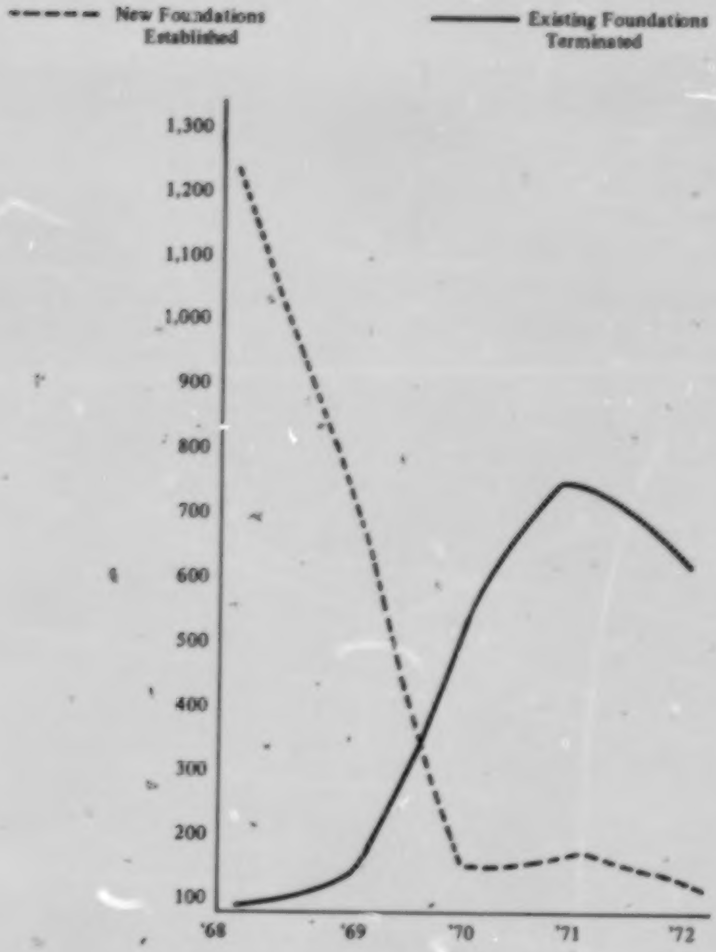
(484 foundations reported a total of 3,630 days)



Average number of days spent by IRS agents on foundation audits = 6 days
Maximum number of days recorded = 220 days
Median number of days recorded = 3 days

Figure B-13

Foundations Established/Terminated, 1968 - 1972, Cumulative of 12 States



From "Analysis of Foundation Center Data on Creation, Dissolution and Reclassification of Private Foundations," Washington, D.C., October 25, 1974, prepared by Caplin & Drysdale and The Foundation Center in Washington, D.C.

Table B-1

Foundation Financial Information, By Foundation Classification

Foundation Financial Information	Foundation Classification			
	Company foundation	Non-company foundation	Operating foundation	Non-operating foundation
Total market value of assets as of 12/31/73	$321,715,415	$17,060,667,717	$931,502,781	$16,442,699,262
Average market value of assets as of 12/31/73	5,274,023	33,850,520	10,831,426	34,516,200
Number of respondents	61	504	86	475
Total grants and expenditures during last tax year	53,050,887	914,577,877	68,864,164	898,312,508
Average grants and expenditures during last tax year	855,659	1,814,638	929,689	1,887,211
Number of respondents	62	504	83	476
Total administrative costs for last tax year	2,036,703	68,804,185	9,236,069	60,336,629
Average administrative costs for last tax year	37,717	140,131	111,278	131,739
Number of respondents	54	491	83	458

Table B-2

Foundation Financial Information, By Market Value of Assets

Foundation Financial Information	Total Market Value of Assets as of 12/31/73			
	Less than $1,000,000	$1,000,000-$4,999,999	$5,000,000-$49,999,999	$50,000,000 and over
Total grants and expenditures during last tax year	$17,807,896	$52,064,566	$187,984,431	$707,163,107
Average grants and expenditures during last tax year	240,647	232,431	890,921	13,095,610
Number of respondents	74	224	211	54
Total administrative costs for last tax year	1,712,030	5,944,011	21,398,207	41,531,575
Average administrative costs for last tax year	29,177	27,519	104,381	783,618
Number of respondents	68	216	205	53

Table B-3

Staff, By Foundation Classification

Foundation Staff	Foundation Classification Company/ foundation	Non-company foundation	Operating foundation	Non-operating foundation
Total executive staff for last tax year	62	915	198	761
Average executive staff for last tax year	2	3	3	3
Number of respondents	31	319	63	285
Total number of others on payroll for last tax year	54	3,023	1,203	1,872
Average number of others on payroll for last tax year	3	13	24	9
Number of respondents	21	230	50	200

Table B-4

Staff, By Market Value of Assets

Foundation Staff	Less than $1,000,000	$1,000,000-$4,999,999	$5,000,000-$49,999,999	$50,000,000-and over
	Total Market Value of Assets as of 12/31/73			
Total executive staff for last tax year	60	247	357	299
Average executive staff for last tax year	2	2	3	6
Number of respondents	36	117	142	52
Total number of others on payroll for last tax year	52	174	791	2,027
Average number of others on payroll for last tax year	3	3	7	41
Number of respondents	18	66	114	49

Table B-6

Foundation Reporting, By Market Value of Assets

	Total Market Value of Assets as of 12/31/73			
Foundation publishes annual report	Less than $1,000,000	$1,000,000-$4,999,999	$5,000,000-$49,999,999	$50,000,000-and over
Yes	30%	25%	48%	83%
No	70	75	52	17
	100	100	100	100
Number of respondents	74	223	211	53
Foundation publicizes grants in other ways				
Yes	44%	31%	48%	80%
No	56	69	52	20
	100	100	100	100
Number of respondents	73	224	212	54

Table 8-6

Number of IRS Audits, By Foundation Classification

Number of IRS Audits	Foundation Classification			
	Company foundation	Non-company foundation	Operating foundation	Non-operating foundation
Total number of audits since 1969	85	696	125	649
Average number of audits since 1969	1	2	2	2
Number of respondents	57	454	78	429

Table B-7

Number of IRS Audits, By Market Value of Assets

IRS Audits	Total Market Value of Assets as of 12/31/73			
	Less than $1,000,000	$1,000,000-$4,999,999	$5,000,000-$49,999,999	$50,000,000 and over
Total number of audits since 1969	90	288	309	87
Average number of audits since 1969	1	1	2	2
Number of respondents	**63**	**197**	**194**	**53**
Total number of days spent by IRS agents on foundation audits	194	690	1,632	1,102
Average number of days spent by IRS agents on foundation audits	3	4	9	22
Number of respondents	**58**	**191**	**181**	**50**

Table B-8

Inter Vivos Gifts, By Market Value of Assets

Inter Vivos Gifts	Total Market Value of Assets as of 12/31/73			
	Less than $1,000,000	$1,000,000-$4,999,999	$5,000,000-$49,999,999	$50,000,000-and over
Total inter vivos gifts received during last tax year	$3,935,833	$16,233,981	$27,360,019	$6,277,683
Average inter vivos gifts received during last tax year	140,565	318,313	739,460	784,710
Number of respondents	28	51	37	8

Table B-9

Bequests, By Market Value of Assets

Bequests	Total Market Value of Assets as of 12/31/73			
	Less than $1,000,000	$1,000,000-$4,999,999	$5,000,000-$49,999,999	$50,000,000-and over
Total bequests received during last tax year	$4,070,800	$5,873,507	$15,422,667	$82,094,261
Average bequests received during last tax year	452,311	225,904	358,667	10,261,783
Number of respondents	9	26	43	8

Appendix C

REASONABLE INVESTMENT EXPECTATIONS AND THE PAYOUT OF PRIVATE FOUNDATIONS*

One of the consequences of the Tax Reform Act of 1969 is section 4942 of the Internal Revenue Code, which requires that private foundations distribute to charity the greater of their current investment income or their "minimum investment return." Subject to some special cases, the minimum investment return was fixed at 6 percent of year-end market value, with a provision for an annual adjustment of this rate. It was apparently anticipated that this payout requirement would leave private foundations able to maintain the "real" value of their assets and their spending, provided they made an effort to invest their assets productively. That is, it was apparently assumed that these foundations could expect a total return of 6 percent plus the effective inflation rate.

On the basis of the analysis that I shall describe, my conclusion is that a foundation with a reasonably aggressive and productive investment strategy can probably afford to pay out between 4.5 percent and 5 percent of market value, and anticipate that the market value of its funds and the market value of its spending will keep pace with inflation in the nation generally. In order to keep pace with the particular rate of inflation that applies to the activities of private foundations (the rate of inflation, for example, in higher education), these foundations should probably be paying out from 3 to 4 percent per year of market value.

Investments of Private Foundations

The assets of private foundations are invested for the most part in common stocks, fixed-income securities (which I shall refer to as bonds) and money market instruments including Treasury Bills, high grade commercial paper, and the like. A number of other possibly more remunerative investment media are available to private foundations, of which perhaps the most obvious are mortgages and real estate equities, but these are also difficult to manage and may be riskier. These other investments present significant problems in terms of developing a capable management staff and achieving necessary diversification. Whatever their availability may be, there seems to be little evidence that they offer the prospect of improved rates of return without increased risk. That is, to the extent that these other investment vehicles could be expected to be more profitable than common stocks, they can also be expected to offer more risk than common stocks.

This is not to say that an all-common stock portfolio will commend itself to most trustees either. Although there will be some exceptions, I believe that the trustees of most private foundations would feel that to invest all of the assets of their foundation in common stocks would be to take excessive investment risk. I think this is a reasonable conclusion, and one that would be supported by the trustees of most educational institutions and indeed by most professional investment managers. The appropriate risk level for most private foundations, then, is probably that risk level corresponding to a portfolio that is partly invested in common stocks and partly invested in something less risky, and therefore probably less profitable, than common stocks.

The point of all of this is simply that whatever the overall investment strategy of a private foundation is or should be, and whatever kinds of investments are made, the overall risk of the portfolio should probably correspond to the risk of a portfolio that is diversified between common stocks and bonds, and therefore the overall rate of return expectations for the foundation should be consistent with expectations for a portfolio divided between common stocks and bonds—a "balanced" portfolio. Statistics on about 150 college and university endowment funds suggest that a portfolio invested 60 percent in common stocks, 30 percent in bonds and 10 percent in short-term investments is about average. I believe that risk characteristics of such a portfolio are appropriate to most colleges and universities and are probably appropriate to most private foundations. The question then is, what can one reasonably expect such a portfolio to produce in the way of total return, and how much of this total return is available for spending if the fund itself and the annual spending are to keep pace with inflation.

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*J. Peter Williamson, The Amos Tuck School of Business, Dartmouth College, October 1975.

Long Run Rates of Return

The first careful study of long run rates of return on common stocks was that of Fisher and Lorie, whose analysis of rates of return on New York Stock Exchange stocks for the period 1926-65 was published in the *Journal of Business* of the University of Chicago in 1968.[1] The single feature of this research that has most impressed investors in common stocks is the 9.3 percent rate of total return that an investor would have obtained over the full 1926-65 period, counting appreciation and assuming reinvestment of dividends, had he divided his money over all stocks listed on the New York Stock Exchange. This number has been taken by many investors as a fair estimate of what one might expect in the way of compound average annual return in the stock market. (Of course private foundations do not reinvest dividends—they are not permitted to under the Tax Reform Act—and the Fisher and Lorie study computed only a 7.3 percent average total return without reinvestment of dividends.)

During the 1926-65 period, the average annual rate of inflation as represented by the Consumer Price Index of the Bureau of Labor Statistics was about 1.5 percent per year. So the average "real" compound rate of return for the Fisher and Lorie study might be taken to be about 7.8 percent per year (9.3 percent - 1.5 percent). And without reinvestment of dividends, the "real" rate was somewhat lower.

In 1974, an analysis of rates of return on common stocks, long term high grade bonds, and treasury bills, for the period 1926-73, was reported by Ibbotson and Sinquefield.[2] This analysis was based upon published and computed indexes, rather than the performances of individual stocks, and was nothing like as exhaustive as the Fisher and Lorie study. But for purposes of practical forecasting, it is probably more useful. Table 1 below summarizes many of the conclusions of the study. The table shows for three classes of investments, for the period 1926-73, the geometric or compound average return, the standard deviation which is a measure of the year-to-year variability in the rate of return, and the geometric average annual "real" return, which reflects the 2 percent per year average inflation over this period, as represented by the Consumer Price Index. All of the rates of return embrace both appreciation and dividends or interest. I have updated the Ibbotson and Sinquefield numbers, and the 1926-74 averages are shown in parentheses.

Table 1

1926 to 1973

	Geometric Avg. Annual Rate of Return	Standard Deviation in Rate of Return	Geometric Avg. "Real" Annual Rate of Return
	(figures in parentheses are updated to cover 1926-74)		
Standard & Poor's Composite ("500") Common stock Index	9.3% (8.4%)	21.9%	7.3% (6.2%)
Long term high grade bonds	3.6 (3.5)	5.0	1.6 (1.3)
Treasury bills	2.2 (2.3)	1.8	.2 (.1)
Rate of inflation	2.0 (2.2)		

The geometric or compound average rate of return is the best measure of the profitability of an investment. But the geometric average "real" rate of return is an even more useful number. So far as common stocks are concerned, the 7.3 percent average "real" return deduced by Ibbotson and Sinquefield is not far from the 7.8 percent "real" return that comes from the

Fisher and Lorie analysis. One can always argue about what periods of time are truly representative and should be used as a basis for making long-run predictions. The period 1926-65 includes enormous variety in economic conditions and stock market performance. There are those who would argue that the depression of the 1930s was an event that cannot be anticipated for the future, so that the experience of this period should not be built into any long run forecast. But there are others who will argue that the great bull market of the 1950s and early 1960s was an event that no one can reasonably expect to be repeated. So I am left with the conclusion that the 1926-65 period is not a bad period to use for prediction purposes. I think it is significant that, even though 1973 was a poor year for common stocks, when Ibbotson and Sinquefield updated this period to 1973 they ended up with an average "real" return over the full period that was not very different from the average "real" return found by Fisher and Lorie.

The Ibbotson and Sinquefield work indicates a geometric average "real" rate of return for long term high grade bonds of 1.6 percent a year. From this, and from a number of other studies of long term interest rates, I estimate a long run geometric average "real" total return of 1.3 percent on long-term bonds. I have even more confidence in the case of bonds than I had in the case of stocks that long run rates of return are correlated with inflation, and that those who purchase bonds will demand what they consider to be a reasonable "real" interest rate plus what they predict to be a long run inflation rate.

The geometric average "real" rate of return on Treasury Bills computed by Ibbotson and Sinquefield was almost zero. I think it is reasonable to predict a "real" interest rate on Treasury Bills over the long run as approximately zero. It turns out that Treasury Bills are about the best inflation hedge one can find, in the sense that Treasury Bills yields correlate very closely with rates of inflation, and are high when inflation is high and low when inflation is low. Unfortunately, they simply are not profitable in "real" terms. This should come as no surprise, since one would expect that the better one is protected against inflation by an investment, the less one is going to make in "real" terms.

"Real" Rates of Return

Table 2 shows long run average "real" rates of return for stocks, bonds, and Treasury Bills.

Table 2

1926–1974 Aveage
"Real" Total Return Rates

Stocks	5.5 – 6.2%
Bonds	1.3%
Treasury Bills	0%

I think this table may be useful in evaluating a spending level. But before drawing any conclusions from the table, I will point out that in deducing "real" rates of return I have been making use of the Consumer Price Index, which is a measure of inflation for the nation as a whole. There are some who would argue that other price indexes are more appropriate for our purposes, and the GNP price deflator is certainly a candidate. But what I think is more important is the strong likelihood that inflation for charitable foundations is likely to be 2 or 3 percentage points higher than inflation for the economy as a whole. Very briefly, the rate of productivity increase in the economy as a whole seems to have been around 2.5 percent during the first half to three quarters of this century. But increases in productivity in education, the performing arts, and I would suppose most of the activities carried on by charitable foundations or supported by charitable foundations has been about zero.[3] This would suggest that the costs borne, either directly or through grants, by charitable foundations have been increasing by some 2 to 3 percentage points above the general rate of inflation.

Tables 1 and 2 and my discussion so far have been based entirely upon market indexes, which we might take to correspond roughly to the results of completely unmanaged portfolios (with no management fees or transactions costs). It may well be that charitable foundations expect their investment managers to add, through their skill, to the returns one might expect on unmanaged portfolios. The management itself, of course, introduces transactions costs. So, for prediction purposes, the question comes down to whether it is reasonable to expect investment managers to more than pay their way. That is, is it reasonable to expect the results of their skill to more than cover their fees and transactions costs? Based upon my observations of the investment performance of college and university endowment funds, foundation funds, pension funds and mutual funds, I am skeptical that a foundation can anticipate any significant improvement in rate of return from its investment management other than the covering of costs. (Investment management has much to offer, of course, besides the hope of higher rates of return.)

The performance record of college and university endowment funds can give us some indication of what has been accomplished with actual, as opposed to theoretical, portfolios. The available data for these endowments do not go back as far in time as the studies I have so far referred to, but it is possible to examine performances over as many as fifteen years ending June 30, 1974. (This is the latest fiscal year-end for which data are available.) Over the 15-year period the average annual rate of total return for 51 endowment funds was 4.78 percent. After adjusting by the Consumer Price Index for inflation, the average annual "real" return was 1.12 percent. These rates are about 1.25 percent below the average total return rate on the Standard and Poor's 500 Index for the same period. (The equity component of these funds in 1974 ranged from 39 percent to 100 percent, and averaged about 60 percent.) The 51 funds had an aggregate value in 1974 of $3.2 billion, perhaps one fifth of the value of all college and university endowments.

Over 10 years ending June 30, 1974, the average annual total return for 80 college and university endowment funds was 2.88 percent, and the average "real" return was minus 1.85 percent. These rates are about 1 percent below the average total return on the S & P 500 Index, and the equity component for these funds ranged from 29 percent to 100 percent in 1974, again averaging about 60 percent. The aggregate size of the 80 funds in 1974 was $4.2 billion, representing probably about a quarter of all college and university endowments.

While these performance records alone are not a sufficient basis for predicting the future rates of return on charitable endowment funds, they do make clear that the funds cannot keep up with a stock market average. And in fact over the 15-year period not one fund was able to achieve an average "real" total return as high as 5 percent a year.

Appropriate Spending Rates

The analyses lead me to the conclusion that foundations can afford to spend 4.5 percent a year of market value and expect to keep pace with national inflation. To do so at a 5 percent spending rate may be difficult but is not impossible. At a 5.5 percent spending rate the likelihood of falling behind inflation is substantial. In terms of keeping up with the rate of inflation that is probably inherent in charitable foundation activities, at a 3 percent spending rate I think a foundation has a good chance of maintaining its purchasing power, and at a 4 percent spending rate it has a fair chance.

My conclusions have been based upon the assumption that a foundation portfolio is invested 60 percent in common stocks, 30 percent in bonds and 10 percent in short-term investments. Some trustees would feel that 50 percent in stocks and 50 percent in bonds would be more appropriate. In this case, my 4.5 percent to 5.5 percent range becomes 4 percent to 5.5 percent, and my 3 percent to 4 percent range becomes 2.5 to 4 percent.

As an aside, I might say that I believe these spending ranges are also appropriate for college and university endowments, so long as the institutions plan to keep pace with inflation. But higher spending rates are justified, and are in fact used, by colleges and universities that can count on significant growth in their endowments through gift additions and are not required to rely on investment performance alone, as are most private foundations.

Results of Spending: 1926-74

As a check on the conclusions I had reached using average performances of indexes, I calculated what would have happened to a portfolio over the time period 1926-74 at different levels of spending. I assumed that the fund was invested 60 percent in common stocks, 30 percent in bonds and 10 percent in Treasury Bills, and that adjustments were made each year to maintain the allocation. And I used the Ibbotson and Sinquefield year-by-year figures to simulate the investment performance of this fund, and the Consumer Price Index to deflate (or in some years to inflate) the fund value and the spending to reflect constant purchasing power dollars.

At a spending rate of 4.5 percent of year-end market value, a portfolio worth $1,000 at the beginning of 1926 would have been worth about $970 (in 1926 purchasing power) at the end of 1974. But in almost all of the other years between 1926 and 1974 the fund would have been worth at least $1,000 in terms of 1926 purchasing power. At a spending rate of 5.5 percent a year, on the other hand, that $1,000 would have shrunk to a purchasing power of about $580 at the end of 1974, and the purchasing power would have been below $1,000 in 5 out of the 6 years following 1968.

Allowing another 2 percentage points of inflation, to account for the extra inflation in the activities of foundations, would have led to a shrinkage from $1,000 to about $800 in the purchasing power of the fund from 1926 to 1974, at a 3 percent spending rate. But for almost all of the other years between 1926 and 1974 the purchasing power would have been $1,000 or more. At a spending rate of 4 percent, however, the $1,000 would have been reduced to a purchasing power of about $480 by the end of 1974, and in all 6 years following 1968 the purchasing power would have been well below $1,000.

I experimented with the possibility that the spending rate in a particular year might be set at the Treasury Bill rate of the preceding year. This is at least a plausible idea, since we know that Treasury Bill rates tend to move with inflation. The results, however, indicate that this would be a quite impractical rule. Applying this rule over the years 1926 through 1974 to a $1,000 fund invested 60 percent in stocks, 30 percent in bonds, and 10 percent in Treasury Bills would have produced a wildly erratic spending pattern, ranging from a low of $1.80 in "real" terms in 1937 to a high of $335.60 in 1970. The purchasing power of the fund would have been well protected. It would have tripled by the end of 1974. But the pattern of spending would have been quite irrational.

These spending tests seem to confirm quite well my prior conclusion that a 4.5 percent spending rate will leave a foundation in a good position to keep up with inflation in the economy generally, while a spending rate of 5.5 percent will make keeping up very difficult indeed. If the test is keeping up with inflation inherent in the activities of private foundations, then the corresponding range is 3 percent to 4 percent.

Footnotes to Appendix C

1. Lawrence Fisher and James H. Lorie, "Rates of Return on Investments in Common Stock: The Year-by-Year Record, 1926-65," *Journal of Business of the University of Chicago*, Vol. 41, No. 3, July 1968, pp. 291-316.

2. Roger G. Ibbotson and Rex A. Sinquefield, "Stocks, Bonds, Bills, and Inflation: The Past and the Future," paper presented at the Seminar on the Analysis of Security Prices, Center for Research in Security Prices, Graduate School of Business, University of Chicago, May and November, 1974.

3. This aspect of inflation has been dealt with by William J. Baumol and William G. Bowen in *Performing Arts—The Economic Dilemma* (New York: The Twentieth Century Fund, 1966) and in the Ford Foundation report, *The Finances of the Performing Arts* (1974), as well as in a variety of books on higher education. The higher education picture is well summarized in G. Richard Wynn, "Inflation in the Higher Education Industry", National Association of College and University Business Officers *Professional File*, Vol. 6, No. 1 (January 1975).

Footnotes

1. That is, to qualify for tax exemption, aims and activities must fall within the definition of "charitable" contained in regulation section 1.501(c)(3)-1(d)(2) issued under the Internal Revenue Code. Throughout this study the terms "charity" and "philanthropy" are used more or less interchangeably and in the broad legal sense of "charitable" as including, for example, the advancement of science and the defense of human rights no less than relief to the poor and distressed.

2. *The Foundation Directory, Edition 4* (New York: The Foundation Center, 1971), p. vii. Andrews was founding head of The Foundation Center and served as its president until 1967.

3. Marion R. Fremont-Smith, *Foundations and Government: State and Federal Law and Supervision* (New York: Russell Sage Foundation, 1965). Chapters I-IV in particular present historical and legal background.

4. For example, George Peabody Education Fund, 1867; General Education Board, 1902; Carnegie Foundation for the Advancement of Teaching, 1905; Milbank Memorial Fund, 1905; Russell Sage Foundation, 1907; Carnegie Corporation of New York, 1911; Rockefeller Foundation, 1913; and The Cleveland Foundation, 1914.

5. This sort of orientation to philanthropy may be said to have been an American contribution, as distinct from the older charitable trusts of England and Europe. However, the approach is no longer exclusively ours, nor, indeed, do all U.S. foundations espouse it.

6. The 1971 *Foundation Directory*, published by The Foundation Center, lists only foundations that either had $500,000 in assets or made grants of more than $25,000 in the year of record (1968-69).

7. For instance, between 1962 and 1972 Rep. Wright Patman issued eight lengthy "installments" on foundations and conducted at least three sets of public hearings. He has also published several other reports, made speeches, and testified before other congressional committees on a number of occasions. While often inaccurate in points of fact and sometimes exaggerated, his work has nevertheless been instrumental and thus therapeutic in pointing out major financial abuses in the foundation field.

8. When John D. Rockefeller was seeking a federal charter for the Rockefeller Foundation in 1910-12, there was vehement opposition denouncing it as a "new form of the dead hand." During 1913-15 the Walsh Commission investigating the general conditions of labor in the United States pictured foundations as a "grave menace" because of their presumed influence in the direction of corporations in which they had large holdings. In the agony of the Great Depression, they were again frequently attacked on these grounds. On the other hand, in the McCarthy era, following World War II, the main attack was on the purported liberalism of foundations in supporting left-wing causes – a set of charges somewhat dissipated when the Cox Commission, established by Congress in 1952 to probe the infiltration of foundations by communists, found instead that foundations had rendered important services in medicine, public health, education, and natural science and had, if anything, a good record in forestalling any potential communist infiltration of American institutions. One member of the commission, Rep. B. Carroll Reece of Tennessee, refused to accept the evidence, and another committee was formed in 1954 under his chairmanship to attempt to investigate again whether foundations were working to overthrow the government by supporting "subversive organizations." A mixed report produced no apparent results.

9. The Gallup Organization, Inc., *Public Awareness and Attitudes Toward Philanthropic Foundations* (Princeton 1972), report of a survey commissioned by the Council on Foundations, Inc.

10. In *Hearings Before the Subcommittee on Foundations, Committee on Finance, United States Senate, October 1 and 2, 1973, on Private Foundations*, p. 74. See also his further observations, p. 107 ff.

11. For varied reasons many organizations use the name "foundation" but meet neither the IRS' nor F. Emerson Andrews' definition. One example is the Seattle Sailing Foundation, much in the news during the summer of 1974 because of the brilliance of its contender, "Intrepid," in the America's Cup trial. It is a fund-raising organization with public charity status.

There are many such examples in the IRS *Cumulative List of Organizations* eligible to receive deductible contributions (Publ. No. 73 rev. to October 31, 19[illegible]). An examination of two random samples from that list and the January and April 1974 supplements showed that 25 percent, or one out of four, of the charitable organizations with names that include the word "foundation" had a "public charity" tax classification, but only one organization in the two samples was a community foundation. If organizations bearing the foundation name that have claimed a "public charity" status but have not yet been classified by IRS (Code "5" organizations) are included, the percentage of organizations that are not private foundations rises from 25 percent to 37 percent.

Such confusions of nomenclature can sometimes have adverse consequences for the reputation of the private foundations. In three notable instances during 1974 where adverse publicity has come to foundations for apparently unseemly practices, the entities involved were in fact not foundations, though they carried the name; they were public charities and hence were not bound by the far stricter rules and regulations under which private foundations operate.

12. The IRS total of 30,000 private foundations does not include some 8,600 non-exempt charitable trusts which are filing as private foundations because all or some Chapter 42 taxes apply. Many of these have discretionary grant-making functions and operate in much the same way as do the private foundations.

13. The 1969 Act provides a rather complex definition of an operating foundation and gives certain more liberal rules for them. Essentially, an organization that makes expenditures of a certain level of magnitude "directly for the active conduct" of its operations is an operating foundation. All other private foundations are technically "non-operating" and come under certain stricter requirements. In fact, many of the larger "non-operating" foundations both conduct programs of their own and make grants.

14. Examples of this category are Charles Thompson Memorial Hall of St. Paul, Minnesota, The Animal Rescue League of Manchester, New Hampshire, and American Medical Society on Alcoholism of New York. See *Cumulative List of Organizations* eligible to receive deductible contributions (pub. No. 78 rev. to October 31,1973).

15. American Association of Fund-Raising Counsel, Inc., *Giving USA*, 1973, and 1974, pp.16-17.

16. A Council on Foundations' survey of contributions received by 60 community foundations over the 5 years 1968-1972 indicated that 46 percent of $40 million received came from private foundations. In a second survey 20 community foundations indicated that between January 1, 1970, and the fall of 1971, they received assets of 91 dissolving private foundations, with transferred assets having a market value in excess of $60 million.

17. Norman A. Sugarman, "Community Foundations," paper prepared for the Commission on Private Philanthropy and Public Needs, 1975.

18. R. Palmer Baker, Jr., and J. Edward Shillingburg, "Corporate Charitable Contributions," paper prepared for the Commission on Private Philanthropy and Public Needs, 1975.

19. The asset value of foundation portfolios, of course, varies significantly with the state of the stock market. A sample survey conducted in late 1974 by the Council on Foundations, involving 18 of the largest and 12 middle-sized foundations, showed them to have had $10.87 billion in assets at the end of 1973. Eight and nine months later, the figure was $8.04 billion. This $2.83 billion drop in assets exceeds total foundation giving in 1972-73. The overall decline for these foundations in the eight-to-nine-month period was 26.07 percent of assets.

20. Note that the definitional criterial differ in Tables A-2 and A-3. Table A-2 presents data on foundations with under $1 million in assets, while Table A-3 excludes those conduit foundations

that had less than $1 million in assets but made grants in excess of $500,000. These foundations typically act as conduits and have been included in Table A-4 to reflect their size more accurately.

21. A special study by the council on Foundations, reprinted in *Hearings Before the Subcommittee on Foundations, Committee on Finance, United States Senate, October 1 and 2, 1973, on Private Foundations*, pp. 36-56. In this study New York City and Washington, D.C., as the headquarters of many national and international charitable organizations, show particularly heavy clusterings of grants received.

22. See *Giving USA*, 1975, op. cit., p. 14. Religion is estimated to have received 43.1 percent of all private giving and education only 14.8 percent during 1974.

23. Ibid, p. 25.

24. Ibid, p. 44.

25. Ibid, p. 6. See also Table A-14, Appendix A, where F. Emerson Andrews traces the history of contributions by sources through 1973. Living individuals are the major source of private philanthropy.

26. The Ford Foundation, for example, received in the neighborhood of 30,000 proposals in 1973; against these, it made 1,116 grants totalling approximately $210 million. The Rockefeller Foundation in 1972 had to issue 5,790 declinations, while it made 439 grants and appropriations. To be sure, not all the requests fit announced fields of interest or merit serious consideration on other grounds. But many more do than can be accommodated by the average foundation. For example, in 1972-73 about one out of seven new proposals received by the Kellogg Foundation fell within its announced program interests. Of 415 eligible proposals, the foundation gave support to 122. It estimates it could have increased its grant making threefold if resources had been sufficient.

27. A 1971 doctoral dissertation by Alan Hedrick Jones examined "Philanthropic Foundations and The University of Michigan, 1922-1965," in order to determine the impact of philanthropic foundations on institutional control and public responsibility at a single institution. The author concluded that the goals and directions of the university and its scholarship and development were served rather than altered by foundation grants. However, university personnel were not precluded from becoming interested in certain projects because money was available.

28. As detailed in The National Planning Association's studies for the Filer Commission, foundation support in fiscal year 1973 surpassed federal expenditures in only one out of five broad areas. In science, education, social welfare, and health, foundation expenditures were on the average equal to 4 percent of the support by the federal government. Only in the case of arts and humanities did foundations outspend the federal government. These comparisons simply reemphasize that more important by far than the volume of foundation giving is where and how it is applied in the individual case and with what effect.

29. The report returns to these considerations in Chapter IV.

30. For two earlier studies assessing the impact of the 1969 Act, see John R. Labovitz, "The Impact of the Private Foundation Provisions of the Tax Reform Act of 1969: Early Empirical Measurements" (Washington, D.C.: American Bar Foundation, 1974), Number 2, and John H. Watson, III, *The Impact of the Tax Reform Act of 1969 on Company Foundations* (New York: The Conference Board, 1973).

31. Reported IRS costs do not, however, include allocations for space, equipment, supplies, or travel.

32. *Report of the Committee on Ways and Means, House of Representatives to Accompany H.R. 13270, August 2, 1969*, p. 19. The committee originally suggested a tax of 7.5 percent upon a private foundations's net investment income, while the Senate called for an annual audit-fee tax of .1 percent of the non-charitable assets of a private foundation Also see *Conference Report No. 91-782 to Accompany H.R. 13270, December 21, 1969*, p. 278, and *Senate Report No. 91-552 to Accompany H.R. 13270, November 21, 1969*. pp. 441-442.

33. Labovitz, op. cit., pp. 32-36.

34. For example, Arnold J. Zurcher and Jane Dustan, *The Foundation Administrator* (New York: Russell Sage Foundation, 1972), p. 20. The study found that 25 percent of the full-time paid administrators were employed by The Ford Foundation and another 15 percent serve the Rockefeller Foundation, while an additional 12 percent comprise the staff of 11 other prominent foundations.

35. See *Tax-Exempt Foundations and Charitable Trusts: Their Impact on Our Economy, Eighth Installment, Staff Report for the Subcommittee on Domestic Finance, 1972.* It presents figures to suggest that foundations expend about $1 in administrative expenses for every $2 distributed to charity. However, institutions listed include a number of large operating charities, such as several private hospitals, whose operating expenses are treated as administrative costs; hence the ratios of administrative costs to grants made in its tabulations are misleading in the extreme.

36. Waldemar A. Nielsen, *The Big Foundations* (New York: Twentieth Century Fund, 1972), p. 277. Nielsen advises foundations to spend more, not less, on staff and administration. He states that high administrative costs and vigorous programs seem to be correlated, as are low costs and timid programs.

37. Malvern J. Gross, Jr., "Foundation Cost Analysis," *Non-Profit Report* (April 1974), Vol. 7, pp. 1,4-7.

38. Ibid.

39. Op. cit., p. 19.

40. When listing executive staff, several large foundations obviously excluded program officers. This is apparent from the maximum number of executive staff listed — 17 people. Where part-time employees were listed by foundations, these have been totaled in our tabulations to equal the number of people on full-time status.

41. During 1973 library users of The Foundations Center's New York collection numbered 7,544 as opposed to 6,719 for 1972 and 5,797 for 1968. The total number of telephone reference calls during 1973 was 6,069 in contrast to 5,583 in 1972. Visitors to the Washington, D.C., library numbered 3,844 in 1973, an increase of 80 over 1972.

42. A recent, separate census from the files of the Council on Foundations and The Foundation Center shows 381 foundations in the United States to have issued annual reports in booklet or folder form for general circulation for the year 1972 or later. This is an increase of 10.7 percent over 1974's total, which in turn was up 12 percent in the previous year.

43. Thus 1975 is the first year for which the full 6 percent requirement has applied to foundations established before 1969.

44. As estimated in American Association of Fund-Raising Council, Inc., *Giving USA*, 1971, 1972, and 1973, foundation giving rose 5.4. percent in 1972.

45. See the report of the influential Commission on Foundations and Private Philanthropy, *Foundations, Private Giving and Public Policy* (Chicago, 1970), pp. 147-149.

46. See note 19, supra, on council survey indicating a 26 percent decline in the assets for 30 foundations from January to September 1974.

47. A basic reference is the study by Lawrence Fisher and James H. Lorie, "Rates of Return on Investments in Common Stock: The Year-By-Year Record, 1926-65," *The Journal of Business of the University of Chicago* (July 1968), Vol. 41, No. 3. It showed total returns from an unweighted "index" of all New York Stock Exchange stocks from 1926 through 1968 of 7.3 percent without reinvesting dividends. The rate of inflation was about 2.3 percent annually for that period. Roughly extrapolating the same data base to the present would bring total returns to less than 5 percent. A capitalization weighted index (the Standard & Poor's 500 Stock Index) shows real total returns of 4.4 percent from 1926-1973. Nicholas Moldowsky's data for

1871-1958 (presented in *Financial Analysts Journal,* 1959), extended into 1974 by applying to them relevant portions of a study by Peter Bernstein of the span from 1901-1973, indicates real total returns from a broader list of stocks over a longer period of between 4.5 percent and 5 percent. All these figures, clustering in that range, are consistent with Philip Cagan's recent work on real total returns in *Common Stock Values and Inflation – The Historical Record of Many Countries* (New York: National Bureau of Economic Research, Inc., March 1974 Supplement). See also unpublished study by J. Peter Williamson, "Reasonable Investment Expectations and The Pay-out of Foundations" (July 21, 1975).

48. See Joseph Goldberg and Wallace Oates, "The Costs of Foundation-Supported Activities," *Foundation News* (July/August 1973), p. 35 ff. See also testimony of Robert F. Goheen and supporting documentation in *Public Hearings Before the Committee on Ways and Means, April 9 and 10, 1973, on General Tax Reform,* pp. 5,801, 5,809-10, 5,823-32.

49. Letter of Assistant Secretary of Treasury Frederic W. Hickman to Sen. Hartke, November 22, 1974.

50. This is recognized in Sen. Hartke's "Statement of the Subcommittee on Foundations" in *The Congressional Record,* October 4, 1974. With respect to the standard used for the MIR by Treasury, the statement advocates more wieght for the Equity side of foundations investment policy and proposes the sort of formula that will incorporate the experience of yields of equities and money rates over *10-year periods,* as in the recently enacted Employee Retirement Income Security Act of 1974.

52. See discussion of audit experience, pp, 1572-73.

53. Organization Management, Inc., *The Tenth Annual Conference on Federal Tax and Other Problems of Non-Profit Organizations,* Michael I. Sanders (February 1974). Sanders points out that the rule limiting the number of scholarships that can be awarded to children of employees to not more than 25 percent of the eligible applicants defeats charitable objectives.

54. The small increase in the percentage of foundations making expenditure-responsibility grants between 1970 and the last tax year is offset by a reduction in the percentage that expenditure-responsibility grants represented of total grants made by the foundations (Exhibit 8, Appendix B).

55. See on this point John G. Simon, "Foundations and Public Controversy: An Affirmative View," *The Future of Foundations* (Englewood Cliffs, N.J.: Prentice Hall, 1973), pp. 58-100 and, most particularly, pp. 73-79.

56. See p. 1566. Estimated man-years directed to the supervision of private foundations by IRS likewise rose from 112 in 1968 to 895 in 1972 and are estimated at 672 for 1974.

57. Testimony of Lee H. Henkel, Jr., chief counsel, Internal Revenue Service, *Hearings Before the Subcommittee on Domestic Finance, Committee on Banking and Currency, House of Representatives, April 5 and 6, 1973, on Tax Exempt Foundations and Charitable Trusts,* p. 223. By December 31, 1974, the IRS is reported to have audited 28,397 private foundations.

58. Letter from Commissioner Donald C. Alexander, Internal Revenue Service, to Howard Marlowe of Sen. Vance Hartke's staff, October 2, 1974, reprinted as Appendix C, *Hearings Before the Subcommittee on Foundations on the Role of Private Foundations in Public Broadcasting, September 9 and 10, 1974,* pp. 146-148.

59. Because of the size limitations referred to, Edition 5 lists only about 10 percent, numerically, of all private foundations. However, *Directory*-listed foundations are believed to account for some 80 percent of all foundation grants and 90 percent of all foundation assets. It seems patently inconceivable that new but smaller foundations would account for the difference between The Foundation Center and IRS' figures.

60. "Analysis of Foundation Center Data on Creation, Dissolution and Reclassification of Private Foundations," Washington, D.C., October 25, 1974, prepared by Caplin & Drysdale and The Foundation Center in Washington, D.C.

61. Senate Committee on Finance and House of Representatives Committee on Ways and Means, *Treasury Department Report on Private Foundations*, 89th Congress, 1st Session, Committee Print, (February 2, 1965).

62. *Hearings Before the Subcommittee on Foundations, Committee on Finance, United States Senate, October 1 and 2, 1973, on Private Foundations*, p. 174 et. seq. Most of Professor Simon's testimony was reprinted in *Foundation News* (January/February 1974), pp. 11-18.

63. These indicators of foundation birth and death rates cited by Professor Simon are reprinted as Exhibit 11 in Appendix B.

64. John Y. Taggart, "Charitable Deduction," *Tax Law Review* (November 1970), p. 63.

65. Labovitz, op. cit., p. 102. Labovitz stresses the necessity of analyzing overall giving patterns among donors who gave to private foundations before 1969 – a topic addressed in the Michigan Survey Research Center's study for the Filer Commission: James N. Morgan, Richard F. Dye, and Judith H. Hybels, "Results from Two National Surveys of Philanthropic Activity."

66. *Treasury Department Report on Private Foundations*. op. cit., p. 71.

67. The fact that required divestiture is delayed for foundations holding control stock when the Act took effect does not mean these rules have *no* effect for 10 years. IRS Commissioner Donald C. Alexander reported to the Subcommittee on Foundations in June 1974 that about $17 million in 4 percent excise tax collections during the government's 1972-73 fiscal year were derived from more than $400 million in realized capital gains by 10 very large foundations, and he attributed the recognition of these gains to foundations putting themselves in a position to comply with the excess-business-holding rules.

68. Except where noted, the following items and quite a number more like them are recorded in detail in Warren Weaver's *U.S. Philanthropic Foundations; Their History, Structure, Management and Record* (New York, 1967). In the order of the listing of items, the specific Weaver references are pp. 29, 262 ff., 412, 417, 349, 365 ff., 272, 252, 233-6, 433, 277, 288-9. Among the examples not included in this summary are those referred to elsewhere in this report. See also Merrimon Cunninggin, *Private Money and Public Service* (New York, 1972), especially Chapter IV, "Counter-Attack: The Record of Achievement," pp. 126-189, for the accomplishments of an extensive list of foundations, including many that are of moderate and even modest size.

69. William G. Wing, *Philanthropy and the Environment* (Washington, D.C.; The Conservation Foundation, 1973), p. 51.

70. Except when noted, statistics about foundation grants to educational television are based on information compiled by Steven D. Cline, Manchester, New Hampshire, in the writing of a Masters' Thesis for submission to the School of Communication, University of North Carolina, and supplemented, as to Pittsburgh foundations, by Sanford Hamilton, a candidate for the doctoral degree in history at New York University.

71. In 1971 a comparable study and report on cable TV, funded by the Sloan Foundation, was issued as a guide to policy makers with respect to this medium, replete as it is with both problems and potential.

72. The Foundation Center's computer service reports that since 1971, 230 grants for educational television, totalling $38,780,000, have been reported to it by foundations across the nation.

73. Much fuller evidence on these points from a variety of sources is now on record in the published *Hearings Before the Subcommittee on Foundations, Committee on Finance, United States Senate, September 9 and 10, 1974, on the Role of Private Foundations in Public Broadcasting*. See also interview with Hartford Gunn by Steven D. Cline, entitled "Public TV: Do Foundations Still Belong in the Picture," *Foundation News* (May/June 1974), pp. 11-20.

74. In the 1972 Gallup Organization's survey on philanthropy, it is noteworthy that 70 percent of those interviewed thought foundations and government should be engaged in attacking the same problems.

75. See Robert W. Hearn, "Foundation Trustees: The Need for Diversity," *Foundation News* (November/December 1974), pp. 11-15. Also, testimony of Robert F. Goheen in *Public Hearings Before the Committee on Ways and Means, April 9 and 10, 1973,* op. cit., pp. 5,832-5,836 reports the results of a Council on Foundations' study on board composition conducted in response to a query by Rep. Martha W. Griffiths.

76. Many examples are to be found in Sarah C. Carey's report to the Filer Commission, "Philanthropy and the Powerless." The report assesses the value of philanthropically supported activity by some of the smaller, family directed foundations in the areas of food and malnutrition, economic development in poverty communities, rural community development, etc.

On August 17, 1975, *The New York Times* reports the death of Blanche Ittleson at the age of 99, a pioneer philanthropist in research and care of emotionally disturbed children and 1953 winner of the Herbert H. Lehman Human Relations Award presented to her by the American Jewish Committee for "exemplary service on behalf of man's understanding of his fellow man." Her philanthropy, and that of her husband, founder of CIT Financial Corp., was carried out through the Ittleson Family Foundation. *The New York Times* obituary reports only one of its many contributions, the first endowed professorship of child psychiatry in the United States at Washington University in St. Louis in 1956. People and families can, indeed, make meaningful contributions to our national well being and no less people and families who happen, by both good fortune and individual effort, to accumulate wealth.

77. Chief proponent of the "tax expenditure" theory is Professor Stanley S. Surrey, brilliant tax theorist of the Harvard Law School and former assistant secretary of Treasury for tax policy. He was instrumental in introducing into Treasury and into the tax-writing committees of Congress the concept of a tax-expenditure budget in which all tax preferences and credits, including the charitable deduction, are treated as costs to government. See, for example, "Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance," *Harvard Law Review* (1970), Vol. 84, No. 352. Powerful arguments against the tax-expenditure analysis with reference to the charitable deduction have been offered by Professor Boris I. Bittker of Yale. See, for example, Bittker, "The Tax Expenditure Budget – A Reply to Professors Surrey and Hellmuth," *National Tax Journal* (1969), Vol. 22, No. 538, and William D. Andrews, "Personal Deductions in an Ideal Income Tax," *Harvard Law Review* (1972), Vol. 86, No. 309. On pages 365-66 of the last reference, Andrews focuses the root disagreement sharply. While the tax-expenditure analysis "regards the tax law as subsidizing charitable contributions in an amount equal to the additional tax that would have been collected if the donated funds had been devoted to private consumption or accumulation," he points out, "The deduction can be described alternatively as a mere exemption of all charitable contributions from the category of private consumption subject to tax."

78. See the unpublished transcript of the Bittker-Surrey debate before the Commission on Private Philanthropy and Public Needs, p. 23 ff. See Bittker also on p. 26: "If you accept the idea that gifts to charity represent a substantially different use than personal consumption, then the charitable deduction is equitable."

79. Irving Kristol, "Taxes, Poverty and Equality," *The Public Interest* (Fall 1974), Vol. 37, pp. 3-28. See especially pp. 13-16.

80. If one were to take that position, would one not have to hold that *any portion* of individual or corporate earnings not taxed would also have to be considered a cost to government? Marxists and those even further to the left might choose to push the thesis that far; few others would. As Kristol's quotation above suggests, perhaps the whole argument turns at root on whether one leans to a Lockeian or more collectivist view of property.

81. Martin Feldstein, *Taxes and Charitable Contributions: Differences in the Impact of Alternative Tax Policies on Religious, Educational and Other Organizations* (Cambridge, Massachusetts: Harvard Institute of Economic Research, November 1974). Also, Feldstein and Amy Taylor, *The Income Tax and Charitable Contributions: Estimates and Simulations with the Treasury Tax Files,* paper prepared for the Commission on Private Philanthropy and Public Needs, 1975.

82. See American Council of Education, *Patterns of Giving to Higher Education II* (Washington, D.C., 1973), p. 10.

83. Council for Financial Aid to Education, *Voluntary Support of Education, 1972-73* (New York, May 1974), p. 6.

84. *Treasury Department Report on Private Foundations*, op. cit., p. 5.

85. See also those of the *House Ways and Means Committee, April 9-10, 1973*, and of Mr. Patman's *Subcommittee on Domestic Finance, House Committee on Banking and Currency, April 5-6, 1973.*

86. See p. 1570 on why expectations of real returns over the 4.5 to 5.5 percent range on broadly diversified portfolios are unrealistic except over brief periods. Actually, real total returns for foundations, as measured against increases in the services they normally support, will usually run 2 percent or so below this range. On this see p. 1570.

87. This was clearly the majority's intent as reflected in the record of the 1969 hearings and the debate in the Senate for example, *Congressional Record*, Senate, December 5, 1969, pp. S15753-S15760). The 5 percent rate originally in the bill as passed by both tax-writing committees was raised to 6 percent on the floor of the Senate after relatively little debate and on the basis of short-term comparisons to the performance of mutual funds that no longer stand up to analysis.

88. See p. 1571.

89. See, especially, Boris I. Bittker, "Should Foundations be Third-Class Charities?" in *The Future of Foundations*, Fritz Heimann, ed. (Englewood Cliffs, N.J.: Prentice Hall, 1973), pp. 132-162.

90. See also, the recommendation of the Forty-First American Assembly in November 1972: "From the public's point of view, the new energy and new ideas that can come from the establishement of new foundations must be encouraged."

91. Various problems are discussed by John Holt Myers, Esq., in *Hearings Before the Subcommittee on Foundations, United States Senate, Committee on Finance, October 1 and 2, 1973, on Private Foundations*, pp. 159-164, not the least of which is complexity. At page 162, he remarks that "The transition rules clearly represent an attempt at a generalized statement to cover a number of specific situations which were brought to the attention of the Ways and Means and Finance Committees. As a compromise reached in conference, it is quite remarkable. As a provision of law, it is practically incomprehensible.

92. These include rules permitting fair-market-value sales to disqualified persons, without treating them as self-dealing transactions, and rules removing accumulated earnings tax obstacles to certain corporate redemptions of such holdings.

93. See Julius Greenfield, assistant attorney general of New York, in *Hearings Before the Subcommittee on Domestic Finance, Committee on Banking and Currency, House of Representatives, April 5 and 6, 1973, on Tax Exempt Foundations and Charitable Trusts*, p. 217: ". . . frequently our experience has shown that the only possible buyer . . . who is willing to offer something worthwhile for the stock held by a foundation is a person who is generally recognized as a disqualified person under the Internal Revenue Code."

94. Myers, op. cit., pp. 161-162.

95. See note 4, supra, for founding dates. See also Arnold J. Zurcher, *Management of American Foundations* (New York, 1972), p. 26, on the frequency with which foundations established by families pass gradually into the control of independent staff and trustees.

96. This is so notwithstanding several strong statements by government officials confirming the supervisory and regulatory rather than revenue-collecting character of the Tax Reform Act of 1969.

97. This description rests heavily on the testimony of Alan Pifer in *Hearings Before the Subcommittee on Foundations, Committee on Finance, United States Senate, October 1 and 2, 1973, on Private Foundations*, pp. 265-267. Along the same lines, see in the same source the testimony of Marion R. Fremont-Smith, pp. 267-271, and Sheldon Cohen, pp. 271-276. Since other fuller studies on the establishment of such an independent agency and the powers that might be assigned to it have been developed for the Filer Commission, we shall not expand further on this recommendation.

PAY-OUT REQUIREMENTS FOR FOUNDATIONS

Eugene Steuerle†

Introduction

The Tax Reform Act of 1969 requires private foundations to make minimum annual charitable distributions equal to their actual income or a stated percentage ("applicable percentage") of their investment assets.[1] The applicable percentage for each taxable year is to bear the same relationship to 6 percent (the rate set for each foundation's taxable years beginning in 1970) as money rates and investment yields for the calendar year immediately preceding the taxable year bear to money rates and investment yields for the calendar year 1969.

The purpose of this paper is to examine these minimum distributional requirements for foundations. The first chapter presents a brief historical review of the current law and proposals to change it. The second chapter deals with serious technical problems in the pay-out requirements which lead to inequities across foundations and inefficiencies in the distribution of their funds. Some proposals to amend the 1969 act so as to eliminate these problems are presented in Chapter III. The fourth chapter discusses from a broader perspective the role of public policy in requiring minimum distributions and analyzes the effect of such requirements on the growth (and perpetuity) of the foundation sector. In Chapter V we examine the impact of these requirements upon the broader charitable sector. Finally, a brief conclusion is contained in Chapter VI.

I

HISTORICAL REVIEW

A 1965 Treasury Report[2] noted that federal tax laws encourage and, in substantial measure, finance private charity. It therefore took the view that society was entitled to current benefits from these tax laws. Contrary to this view, the report found that a number of foundations were making substantial deferrals of grants for charitable purposes and instead were accumulating the income that was earned on their assets. Recognizing that this income could be accrued both directly through dividend or interest payments and indirectly through appreciation in the value of assets, the report recommended that each private non-operating foundation be required to distribute net income on a reasonably current basis and that where actual income was below a "reasonable" rate of return for a diversified portfolio, each foundation be required to distribute a percentage of its investment asset value equal to that "reasonable" rate of return. The Treasury Secretary was to be given authority to adjust the applicable rate from time to time depending upon market conditions.

Both the Johnson Administration in 1968 and the Nixon Administration in 1969 supported this proposal. The April 22, 1969, Tax Reform Proposals of the Nixon Administration suggested a 5 percent minimum distribution requirement but made no mention of annual or periodic adjustment. While the House of Representatives accepted this 5 percent rate, the Senate did not, and a fair amount of debate ensued there on the question of the appropriate rate for pay-out. The Commission on Foundations and Private Philanthropy,[3] chaired by Peter G. Peterson, reported to the Senate Finance Committee its conclusion that the 1959-1969 experience of balanced investment funds indicated that a reasonably managed foundation could maintain its size in *real* dollars with a pay-out of about 6 to 8 percent. While the Senate Finance Committee kept the 5 percent minimum pay-out that was contained in the House bill, Senator Percy successfully advanced an amendment on the floor to raise the minimum pay-out to 6 percent. Since a previous unsuccessful effort had been made to impose a "limited life" on foundations, support for the 6 percent rate came not only from those who felt that such a rate reflected the real rate of return on assets held by a typical foundation, but also from those who did not wish to grant an indefinite life to foundations. Similarly, opposition to the 6 percent rate was supported by those who felt that a lower rate more appropriately reflected returns on assets, as well as by those who did not wish to inhibit the growth of foundations by any means. In any case, the Treasury Department supported the 6 percent rate before the Conference Committee, and the Percy amendment was maintained in the final act.

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The 1969 act also allowed for annual adjustments in the pay-out rate by requiring that "the applicable percentage for any taxable year beginning after 1970 shall be determined and published by the Secretary of Treasury or his delegate and shall bear a relationship to 6 percent which the Secretary or his delegate determines to be comparable to the relationship which the money rates and investment yields for the calendar year immediately preceding the beginning of the taxable year bear to money rates and investment yields for the calendar year 1969."[4]

Thus, the required pay-out would rise or fall as the previous year's "money rates and investment yields" rose and fell. As discussed in Chapter II, there was far too little debate on the problems that would arise with this method of adjustment.

Table 1 presents the pay-out requirements that were applied to foundations for the years 1970 to 1975.

Table 1

Pay-Out Rates for Foundations[a]

Year	Foundations Organized Before May 26, 1969	 After May 27, 1969
1970	6.0%	NA
1971	6.0	NA
1972	5.5	4.125%
1973	5.25	4.375
1974	6.0	5.5
1975	6.0	6.0

a. Foundations must distribute this percentage of net worth or actual income, whichever is higher.

In applying the prescribed formula for determining these pay-out rates, the Treasury Department in recent years has been using the yield on five-year Treasury securities[5] as its measure of "money rates and in investment yields." However, the application of the formula has not always been strict.[6]

Note that transitional rules applied to foundations established before enactment of the 1969 law. No "applicable percentage" was applied to these foundations before 1972, and thus they were not required to distribute 6 percent of net worth until 1975. Along with this increase in pay-out requirements for "older" foundations came the steep stock market declines of 1973 and 1974. Combined, these changes served to enhance the view of many foundation trustees that the pay-out requirements were forcing a decline in foundation net worth.

Since adoption of the 1969 act, several attempts have been made to reduce distributional requirements. For instance, in 1971 a bill was introduced in the House to allow foundations to compute their minimum pay-out using the acquisition date value of their assets rather than current fair market value. This type of proposal would work to nullify the intent of the actual law to take into account all returns of the foundation's portfolio, whether realized or not. Other attempts usually involved simple proposals to lower the basic 6 percent rate to 5 percent, 4 percent, or less.

In November 1974 the Subcommittee on Foundations of the Committee on Finance of the Senate held hearings on the "Impact of Current Economic Crisis on Foundations . . ." Again, arguments against forced "invasion of corpus" were heard, along with the contention that the basic 6 percent rate was unrealistic when compared with current market conditions and rates of return. A later statement of the Senate subcommittee recommended that a definite standard be set for setting the applicable percentage, although the subcommittee made no recommendation as to the appropriate rate around which that percentage would revolve.

In December 1975 the Commission on Private Philanthropy and Public Needs stated that the current "payout rate is higher, by a significant degree, than the yield that can be anticipated from a balanced investment portfolio."[7] It therefore recommended that a flat pay-out rate of 5 percent be fixed by Congress. However, there were dissents from that opinion. The dissenters in particular noted that "the slow dispersal of a foundation is not necessarily a bad thing if new ones are being continually created."

At about the same time as the release of the Filer Commission Report, the Treasury Department stated in a letter to Senator Curtis that it supported his bill to establish a fixed minimum pay-out of 5 percent. Part of this support reflected a position that 5 percent more closely approximated the long-term rate of return on foundation assets. However, no matter what rate was chosen, the Treasury voiced considerable support for elimination of the annual adjustment in the pay-out rate and its replacement with a flat rate.

Finally, early in 1976, Treasury ruled that based upon money rates and investment yields in 1975, the minimum pay-out rate would be raised to 6.75 percent for 1976.

As one can see from this brief historical review, much of the public debate regarding distributional requirements for foundations centered on the empirical question of the actual rate of return received by foundations on their portfolios. This paper does not direclty address that question, but assumes that the actual rate can be appropriately measured by the historical rate of return received on the assets of a typical foundation portfolio. It is important that the empirical question of rates of return received by foundations be separated from the policy question of the appropriate level of pay-out for foundations. The answer to the empirical question provides information by which the policy question can be addressed, but the empirical question is in no way dependent upon the answer to the policy question. In the remainder of this paper, alternative policies toward foundations (for example, "limited life," "no growth," or "growth and perpetuation") will be expressed in terms of the *relationship* between the long-term pay-out rate and the long-term rate of return received by the foundations. A more restrictive policy (limited life) is one in which the pay-out rate exceeds the rate of return while a more liberal policy (growth and perpetuation) is one in which the rate of return exceeds the pay-out rate. Chapters II and III treat the difference between the two rates as given by a predetermined national policy toward foundations. These chapters address the question, How should the current formula for required pay-outs be adjusted so as to promote equity among foundations and efficiency in the distrubution of their funds? The remaining chapters will separately discuss how the growth of individual foundations and the foundation sector is affected by any difference between these two rates.

II

EQUITY AND EFFICIENCY OF CURRENT DISTRIBUTIONAL REQUIREMENTS

No matter how large or how small the required rate of pay-out over the long run, a policy of required distributions for foundations should meet certain tests of efficiency and equity. First, any law should meet a standard of horizontal equity – that is, foundations should not be forced to make greater distributions because of a conservative investment policy in any particular year. Second, the pay-out rate itself should not vary with short-term fluctuations in interest rates nor with changes in nominal yields due to inflation. Finally, required distributions (as well as the pay-out rate itself) should not fluctuate greatly from year to year. Unfortunately, the current set of distributional requirements fails to meet all of these tests.

Horizontal Inequity in Distributional Requirements

A foundation's minimum required distribution is not merely a stated percentage of its investment assets, but rather the maximum of that number and actual income. Since actual income is based upon an accounting concept of realization which ignores non-realized capital gains and losses, actual income could be greater than economic income. This occurs when the average price of the foundation's assets decline in value. Thus, introduction of an extraneous "actual income" rule means that foundations will on average distribute more than an "applicable percentage" of their net worth. While in principle there is no reason why the average required distribution rate should not rise above the minimum pay-out rate, use of an "actual income" rule is not an equitable nor efficient means of increasing the average percentage of assets distributed. Certainly those foundations most affected by the "actual income" rule are ones that actually realize a greater proportion of their total income, that is, those foundations that invest primarily in bonds and similar assets rather than stocks. Since bonds in general average lower rates of return over time than do common stock equities, foundations with a lower rate of return are in effect required on average to distribute a larger portion of their net worth. If the purpose of including actual income in the distribution rule is to raise the average distribution rate somewhat above the minimum pay-out rate, then that can be accomplished more easily by increasing the pay-out rate itself. In any case, foundations should not be penalized as under current law for conservative investment policies.

Deficiencies of the Current Formula

Recall that the Secretary of the Treasury is required annually to adjust the pay-out rate so that it bears the same relationship to 6 percent as money rates and investment yields for the calendar year immediately preceding each taxable year bear to money rates and investment yields for calendar year 1969.

Since "money rates and investment yields" were never specifically defined in the law, the Treasury Department decided to measure these rates by the yield on five-year Treasury securities. Most foundations, however, invest primarily in assets whose yields are not closely correlated with the yield on Treasury securities. Consequently, the annual adjustments to the pay-out rate did not reflect changes in the real rate of return on assets held by foundations.

Why, then, did the Treasury Department use five-year Treasury securities to measure money rates and investment yields? The Treasury Department was constrained by the requirement that the pay-out rate be adjusted to reflect market returns *for the calendar year immediately preceding each taxable year.* Prices of assets such as stocks vary a great deal from one year to the next. If Treasury were to calculate yearly investment yields by including price changes as well as dividend yields, then pay-out rates of -33 percent, -20 percent, or +50 percent would be common. The alternative available to Treasury is to use an asset that has less price fluctuation and whose interest varies less than short-run interest rates (a bond with a few years to maturity, for example) and to let its investment yield approximate the average investment return of foundations. Treasury's use of interest rates on certain Treasury obligations thus represented an unsatisfactory, although simple, resolution to its dilemma.

The current formula for calculating the "applicable percentage" is deficient in another respect: it fails to take into account the effect of changes in the rate of inflation upon the rate of return on assets. With an increase in the rate of inflation, nominal yields can easily rise at the same time that real yields remain constant. If the pay-out rate is indeed supposed to adjust to the real rate of return on assets, then inflation must be explicity taken into account in any formula for determining that pay-out rate.

In summary, the Internal Revenue Service Code sets an initial pay-out rate equal to 6 percent for 1970, and then proceeds to require adjustments in that pay-out rate according to a yearly rate of return which Treasury interprets as the nominal rate of interest on some of its own obligations. Thus, the pay-out rate now fluctuates with changes in nominal interest rates and yields without regard to whether changes in nominal interest rates represent changes in the long-run real rate of return received by foundations on their assets.

Instability of Distributions

Even if the wording of the law was changed so that the "applicable percentage" was made constant or changed only as the long-term real rate of return on assets was perceived to change, one major problem would remain. Because the "applicable percentage" is applied to the aggregate fair market value[8] of all assets (less acquisition indebtedness) of the foundation, the size of required distributions may fluctuate from one year to the next whether or not the "applicable percentage" changes. The percentage change in the size of required distribution will be equal to the percentage change in the aggregate fair market value of assets even when the pay-out rate remains constant.[9] Given the volatility of stock and bond prices, the present formula subjects minimum foundation distributions to similar volatility.

This sizable fluctuation in required distributions creates two problems. First, it leads to suboptimal planning on the part of the foundations. Many projects need substantial lead time to develop. Sudden increases in the value of a foundation's portfolio may require a foundation to make distributions for which it may have inadequately planned.[10] On the other hand, sudden decreases in valuation may encourage a foundation to abandon projects and commitments if it felt that required distributions had been too high in previous years.

Second, because foundations are heavily invested in the stock and bond markets and because changes in stock and bond prices generally act as a leading indicator of a similar directional change in national production,[11] minimum foundation distributions are pro-cyclical in nature. That is, a decline (increase) in stock prices will lower (raise) the amount of distributions that foundations must make, and this reduction (increase) in distributions will likely accompany a downswing (upturn) in the economy. Required distributions are thus pro-cyclical in terms of national income and counter-cyclical in terms of needs. When unemployment, national income, and similar measures indicate that the needs of society are greatest, distributions from foundations are likely to be reduced along with other private charitable giving. Later in the paper, it is argued that the principal justification for the separate existence of private foundations within the charitable contribution sector is that foundations must be able to fulfill functions and meet needs unlikely to be met by other parts of that sector. Yet, the current formula for calculating minimum distributions requires increased pay outs when least needed, encourages decreased payouts when most needed, and thus effectively acts as a disincentive to foundations to play a significant and separate role during recessionary periods.

III

RECOMMENDATIONS FOR REVISION IN REQUIREMENTS FOR DISTRIBUTION

In the previous section it was concluded that distributional requirements could meet certain tests of equity and efficiency only if (1) foundations were not forced to distribute a greater portion of their assets because of conservative investment practices, (2) pay-out rates adjusted only to changes in the long-term expected real rates of return on assets, and (3) minimum required distributions did not fluctuate too much from year to year.[13]

How might the current law for minimum distributions by foundations be revised so as to meet these standards of equity and efficiency? First, the "actual income" part of the minimum distribution rule should be eliminated. It makes no sense to have a pay-out rate based upon a concept of economic income that recognizes unrealized capital gains and losses and then to have an alternative distribution rule based upon realized income only. All distributional requirements should be consistently based upon a concept of total income and not nominal realized income. Besides, as noted in the previous chapter, the actual income rule in general requires greater distributions from those foundations that have a lower real rate of return.

The second revision necessary is to eliminate the requirement that the pay-out rate reflect money rates and investment yields for the preceding calendar year. The mandatory pay-out should be related to the long-term real rate of return on foundation investments; that rate can be approximated by geometric mean of the total real rate of return to an "average" foundation portfolio held over an extended time span. There exists a fair amount of information by which such a calculation can be made. For instance, both the dividend and price change components of all stocks listed on the New York Stock Exchange for a period of about five decades is currently available. A suitable arrangement could be made whereby the pay-out rate would be recalculated every few years (or every year if desired) so that returns for the most recent years would be included in the computation. The beginning year for calculating the geometric mean rate of return could be either fixed or adjustable, for example, the rate could be calculated by the geometric mean of annual returns from 1926 to present or from 40 years ago to present.

Since a measure of a long-run rate of return based upon a historic series will vary much less than will annual "money rates and investment yields," adoption of this revision will eliminate much of the annual variation in the pay-out rate itself. More importantly, this revision would assure that changes in the pay-out rate reflected only changes in the long-run real rate of return rather than short-run nominal yields.

Nonetheless, even with adoption of this second revision, there will remain sizable fluctuations in required distributions from year to year because of the fluctuations in the base to which the pay-out rate is applied. To increase stability of distributions, minimum distributions should not equal the pay-out rate times the monthly average of the value of foundation portfolio in the previous year – the procedure adopted in the current law. But rather, the base to which the pay-out rate is applied should be a weighted average of the value of the foundation's net worth over several years.

Two minor problems arise when the base is thus expanded. First, inflation understates the value of the portfolio in a past year if that value is not converted (inflated) to present value. Secondly, new contributions must be treated separately from that portion of net worth that is due to past contributions. These procedures are dealt with later. At this point, however, assume that the world is one with no inflation or deflation and that no new contributions are received by the foundation. How then might such a minimum distribution formula be derived?

The simplest and, administratively, the most feasible way would be to let the size of the previous year's distribution serve as a summary measure of the value of the portfolio in previous years. In other words, let

D_t = Minimum distribution in year t;

A_t = Asset value at beginning of year t;

α = Pay-out rate;

β = An arbitrary number indicating the proportion of the total base to be determined by the value of the portfolio in the current year.

Then let

$$D_{t+1} = D_t + \beta\,[\alpha A_{t+1} - D_t] \qquad (1)$$

If the rate of return on the portfolio for each year t equals the minimum pay-out rate, and the foundation only distributes the minimum required by law, then formula (1) can be seen to collapse to the requirement that $D_{t+1} = D_t$.

Equation (1) can also be rewritten as

$$D_{t+1} = (1 - \beta)\,D_t + \beta\,[\alpha A_{t+1}] \qquad (1')$$

thus inferring that required distributions in time period t + 1 are a weighted average of distributions in time period t and the pay-out rate times value of assets during period t+1. It can also be noted that

$$\begin{aligned} D_{t+2} &= D_{t+1} + \beta\,[\alpha A_{t+2} - D_{t+1}] \\ &= \beta\alpha A_{t+2} + (1 - \beta).\beta\alpha A_{t+1} + (1 - \beta)^2 D_t \qquad (2) \\ D_{t+n} &= \beta\alpha A_{t+n} + (1 - \beta)\beta\alpha A_{t+n-1} + (1 - \beta)^2 \beta\alpha A_{t+n-2} + \dots \\ &\qquad + (1 - \beta)^{n-1} \beta\alpha A_{t+1}\,(1 - \beta)^{t+n} D_t \end{aligned}$$

In formula (2) the last term $[(1 - \beta)^{t+n} D_t]$ approaches zero as n becomes large. Thus, required distributions in a given year can be viewed as equal to the pay-out rate (α) times a weighted average (β, $(1-\beta)$ B, $(1-\beta)^2 \beta \dots$) of total asset value of the foundation (A_{t+n}, A_{t+n-1}, A_{t+n-2}) in the current year and previous years.

The advantage of using a weighted average of previous asset values as shown in (2) is twofold. First, greater weight is given to current asset values than to past asset values. A simple averaging method would require assignment of equal weights to asset values for each year included in the average. Secondly, formula (2) collapses to the administratively simple formula shown in (1'). A foundation need know only its net worth in the current year and required distributions in the previous year to calculate its required distributions for the current year.

So far it has been assumed that the value of the dollar was constant and that the foundation received no new contributions. By successively relaxing these restrictions, modest revisions are added to formula (1).

To account for inflation, formula (1) can still be used, except that D_t would be converted to reflect the level of prices in time perio[illegible] 1. Thus if the rate of inflation in period t is i_t, then $D_{t+1} = (1 - \beta)\,(1 + i_t)\,D_t + \beta\,(\alpha A_{t+1})$. (3)

It can be seen that such an inflation adjustment effectively converts each A_{t+Z} term in equation (2) into the term $A_{t+Z}\left[\frac{t+n-1}{t+Z}(1+i_m)\right]$ by period n, or that the minimum distribution is still α times a weighted average of the net worth of the foundation in previous years, only now net worth in past years is converted to current dollars.

Again, there is no added work for the foundation to calculate its minimum distribution, since the numbers $(1-\beta)(1+i_t)$ and $\beta\alpha$ can be calculated yearly by Treasury, and the foundations need only plug the values of D_t and A_{t+1} into formula (3). In fact, with low rates of inflation, the difference in required distribution between formula (1) and (3) is of a low enough order of magnitude that it may be simpler to forego the adjustment altogether.

Next, there must be an appropriate method for separating new contributions in period t from the net worth of the foundation in period t + 1. Otherwise, distributions from new contributions will be required at a rate that is only a fraction[13] of the pay-out rate. Formula (3) can be revised so that

$$D_{t+1} = (1-\beta)(1+i_t)D_t + \beta[\alpha(A_{t+1}-C_t)] + \alpha C_t \qquad (4)$$

Where C_t = value of contributions in time period t.

Note, however, that the reformulation proposed in (4) is not necessary to limit eventually the growth of the foundation's portfolio from the reinvestment of its income. If a new contribution were merely treated as part of A_{t+1} as in (3) or (1), then in the first few years the required distributions deriving from the contribution alone would be less than the pay-out rate. Thus, at first, there is a lower pay-out for new contributions than there is for other retained assets of the foundation. However, eventually the rate of required distributions on all assets approaches the pay-out rate.

In Chapter V we argue that foundations receiving new contributions would be more likely to distribute funds toward currently recognized needs of society. Pay-out requirements for foundations were established by Congress to limit the growth of foundations from income, not contributions. For new contributions, therefore, it may be reasonable at first to lower the pay-out rate (for example, by foregoing the adjustment in formula (4)) or to allow a carryover of the required pay-out (αC_t) for a short period of time. Since foundations often need time to plan for expenditures from new contributions, such an alternative treatment of contributions could improve the efficiency of the distribution process.

The revised distribution rules proposed here would succeed where the current formula fails. The minimum pay-out rate would adjust to the long-term rate of return on assets, and minimum distributions would become more stable over economic cycles. Efficiency in distributions would be enhanced and equity across foundations would be promoted.

A summary of the recommendations of this section are as follows:

1. Eliminate the requirement that distributions must equal actual income whenever actual income is greater than the pay-out rate multiplied by the net worth of the foundation. Adoption of this recommendation will lower average distributional requirements. An equivalent rise in the pay-out rate may then be desired.

2. Adjust the pay-out rate periodically to reflect the long-term real rate of return on a typical foundation portfolio rather than the nominal rate of return on Treasury notes.

3. Determine each foundation's minimum required distribution by a weighted average of the previous year's distribution and the current net worth of the foundation multiplied by the pay-out rate. Equivalently, apply the pay-out rate to a weighted average of the net worth of the foundation in previous years. In addition, allow an extension of the time during which distributions required because of the previous year's contributions must be paid.

IV

A QUESTION OF PERPETUITY

Any pay-out requirement, no matter how small, affects the ability of an organization to grow. Certainly, the greater the amount of income that is disbursed, the lesser the accumulation of funds in a foundation's portfolio. Some individuals have extracted from this simple relationship an argument that the current pay-out rate will "bring about a slow but certain death sentence" to foundations.[14]

So far in this paper this argument has been ignored in order to focus better on inadequacies in the present law which are present no matter what the average pay-out rate over time. Now, however, we must turn to this argument because nowhere, it is felt, has the relationship between growth and a required pay-out been systematically analyzed.

The effect of the pay-out rate on a foundation receiving no new contributions will be discussed first. Then the relationship between the pay-out rate, the rate of return on assets, and the rate of contributions will be analyzed in order to examine the effect of this relationship on the growth and survival of the foundation sector as a whole.

Growth of Individual Foundations

What will the pay-out rate mean to an established foundation receiving no new contributions and distributing the minimum required by law? Clearly, the answer depends upon the rate of return on its assets. The relationship between these two rates and the net worth of the foundation is demonstrated in Table 2. In this Table the half-life of a foundation indicates the amount of time it will take for the *real* net worth of the foundation to halve, given the difference between the pay-out rate and the real rate of return on assets. This simple calculation reveals that when the pay-out rate is marginally greater than the real rate of return on assets, the net worth of a foundation receiving no new contributions will be reduced at a very gradual pace.

Recall from the first chapter the current efforts to reduce the basic pay-out rate to 5 percent. One of the principal arguments given for this reduction was that 5 percent represented the real rate of return achievable by a foundation portfolio and that pay-out requirements were therefore about 1 percent higher than this rate of return. Table 2 reveals that if this argument is correct, the real net worth of an "average" foundation receiving no new contributions will halve in about 70 years.

Table 2

Half-Life of Foundations Receiving No Contributions

Pay-out Rate Minus Rate of Return on Assets	Half-life (Years)
.00	Infinity
.01	69
.02	35
.03	23

Should the pay-out rate, then, be lowered to 5 percent? The answer depends upon the objective of public policy toward foundations. The argument was made earlier that this policy should be formulated in terms of the relationship between the pay-out rate and the real rate of return on assets. Once it is agreed what the appropriate difference, if any, between these two rates should be, then the pay-out rate can adjust as the perception and knowledge of real rates of return also change. A simple method to allow for periodic adjustment in the pay-out rate was presented in the previous chapter. In any case, a consistent public policy toward foundations requires that the relationship between the pay-out rate and the long-term rate of return on assets also be consistent. Therefore, the argument to lower the estimate of the long-term rate of return after a period in which equity prices have declined can only be valid if one is also willing to raise that estimate when those prices rise.

This micro-analysis of the effect of a pay-out rate on individual foundations receiving no new contributions will now be followed by analysis of its effect on the growth and perpetuity of the foundation sector as a whole. While the micro-analysis may be of more concern to established foundations, policymakers must be as concerned with the general effect of distribution rules sector-wide as they are with the specific effects of these rules on certain foundations.

To assume that the effects of a pay-out rule on the foundation sector would be the same as its effects on individual foundations receiving no new contributions would involve a fallacy of composition. The ability of a given foundation to grow is dependent not only upon the relationship between the rate of return on its assets and the pay-out rate, but also upon the rate at which that foundation acquires new contributions. In like manner, the foundation sector's survival is dependent upon the survival of existing foundations only if it is predicated that no new foundations will be formed.

A Model of Foundation-Sector Growth

To examine the relationship between the real rate of return on assets, the foundation pay-out rate, the rate of growth of contributions, and the size (or survival) of the foundation sector over time, make the simple assumption that each of these rates are constant over time. That is, let

r = real rate of return on foundation sector net worth;
p = foundation pay-out rate;
e = rate of growth of contributions to the foundation sector.

Also let

F = net worth of foundation sector at the beginning of time period 1;
C_t = contributions made to the foundation sector in time period t;
W_t = national wealth in time period t;
A_t = net worth of the foundation sector in time period t;
w = rate of growth of national wealth;
x = $1+r-p = 1+$ annual rate of growth (decline) of value of foundation assets, given minimum payout and excluding increases due to contributions;
g = $1+e$ = ratio of contributions to the foundation sector in time period t+1 over those received in time period t;
a = $1+w$ = ratio of national wealth in time period t+1 over national wealth in time period t.

Suppose that the contributions are made at the beginning of each time period. Then the net worth of the foundation sector at the beginning of any time period can be calculated as follows:

$$A_1 = C_1 + F \tag{5}$$

$$A_2 = A_1 \cdot x + C_2 = C_1 \, [x + g] + Fx \tag{6}$$

$$A_3 = A_2 \cdot x + C_3 = C_1 \, [x^2 + gx + g^2] + Fx^2 \tag{7}$$

$$A_n = A_{n-1} \cdot x + C_{n-1} = C_1 \, [x^{n-1} + g \cdot x^{n-2} + \ldots + g^t \cdot x^{n-t-1} + \ldots. + g^{n-1}] + F \cdot x^{n-1} \tag{8}$$

$$= C_1 \cdot h(n) + F \cdot x^{n-1} \text{ where}$$

$$h(n) = \sum_{t=0}^{n-1} x^{n-t-1} \cdot g^t$$

$$\text{Now } h(n) = g^{n-1} \, [1 = \frac{x}{g} + (\frac{x}{g})^2 + \ldots + (\frac{x}{g})^{n-1}]$$

$$\text{Hence } A_n = C_1 \cdot g^{n-1} \left[\frac{1 - (\frac{x}{g})^n}{1 - \frac{x}{g}} \right] + F \cdot x^{n-1} \tag{8'}$$

These equations demonstrate that the question of the foundation sector's survival is almost superficial. No matter how high the required pay-out rate, the foundation sector will survive as long as it receives new contributions.

A more important question is, Can the foundation sector grow given a pay-out requirement? To answer that question, the short-run and the long-run effects of a pay-out rate on the net worth of the foundation sector need to be analyzed.

To deal with the short-run effect we will examine the change in net worth of the sector from one period to the next, given a stock of assets "F" in the first period. From equations (5) and (6) note that the asset value of the foundation sector will decline if

$$A_2 - A_1 < 0$$

$$\rightarrow C_1 \, [x + g - 1] + F \, [x - 1] < 0$$

$$\rightarrow C_1 \, [g + r - p] < F \, [p - r]$$

$$\rightarrow \frac{C_1}{F} < \frac{[p - r]}{g - [p - r]} \tag{9}$$

Since "g- (p-r)" is only slightly different from 1, equation (9) states roughly that the net worth of the foundation sector will decline in any year in which the pay-out rate is greater than the rate of return on assets plus the ratio of new contributions to value of assets.

The long-run effect, however, may differ from this short-run effect. From equation (8), we note that

$$A_n - A_{n-1} = C_1 [x^{n-1} + (g-1) \cdot (x^{n-2} + x^{n-3} \cdot g + \ldots + x \cdot g^{n-3} + g^{n-2})] + F \cdot x^{n-2} \cdot (x-1)$$

$$= C_1 \cdot x^{n-1} + C_1 \cdot e \cdot h \ (n-1) + F \cdot x^{n-2} \cdot (r-p)$$

Only the last term $[F \cdot x^{n-2} \cdot (r-p)]$ can be negative with stable or growing contributions (that is, where $(g-1) = e > 0$) and even then only when the pay-out rate is higher than the rate of return on assets. If $p > r$, as n becomes large, x^{n-1} and x^{n-2} become small and $A_n - A_{n-1}$ approximately equals $C_1 \cdot e \cdot h \ (n-1)$ which in turn approximately equals $e \cdot A_{n-1}$ no matter how large the pay-out rate. Thus, over the long-run, the growth rate of foundation-sector net worth will not be less than the rate of growth of contributions to that sector.

If one is concerned about an institution or a sector's impact upon the economy over time, the concern should be more with the size of that institution relative to the size of other institutions than with the institution's absolute size alone. Therefore, it may be useful to analyze under what conditions the net worth of the foundation sector rises relative to national wealth:

From (8')

$$\frac{A_n}{W_n} = \frac{C_1}{W_1} \cdot \frac{g^{n-1}}{a^{n-1}} \cdot \frac{1 - (\frac{x}{g})^n}{1 - (\frac{x}{g})} + \frac{F \cdot x^{n-1}}{W_1 \cdot a^{n-1}}$$

Under these conditions, the size (assets) of the foundation sector relative to national wealth will have a finite limit as long as

$$x < g \leq a \quad \text{or}$$

$$p > r-e \geq r-w$$

or, in other words, the pay-out rate is greater than the rate of return on assets minus the rate of growth on contributions, and the rate of growth of contributions is less than or equal to the rate of growth of national wealth. Since this latter requirement[15] appears quite reasonable over the long-run, it will be assumed throughout the remainder of this chapter.

The effect of the pay-out rate upon the growth of foundations is summarized in Table 3.

As we have mentioned before, much debate has centered around the question of whether the pay-out rate set by the Secretary of the Treasury has approximated the real rate of return on assets or whether, given current economic conditions, the pay-out rate has been higher. This debate has much less significance to the foundation sector than it does to individual foundations. As long as the pay-out rate is greater than the rate of return on assets minus the rate of increase in contributions, the net worth of the foundation sector will stabilize at some size which is a fraction of national wealth. And as long as the foundation sector receives new contributions, its survival is assured. The case where the pay-out rate is equal to the rate of return is then merely a requirement that falls between these two extremes. The perpetuity of

Table 3

Effect of Pay-Out Rate on Foundation-Sector Growth

Case	Pay-out Rate	Effect
(1)	$p < r-e$	Both the absolute and relative of the foundation sector grows without bounds.
(2)	$p > r-e$	The wealth of the foundation sector as a whole stabilizes at some fraction of national wealth.
(3)	$p > r-w$	Foundations receiving no new contributions decline in size relative to national wealth.
(4)	$p = r$	The pay-out rate equals the real rate of return on assets. By some accounts, this rule best describes congressional intentions with regard to the pay-out rate. Foundations cannot grow in real terms without new contributions. The sector as a whole, however, will grow in absolute size without bound as long as new contributions are received, and, in fact, it will grow by exactly the amount of the new contributions.
(5)	$P_t > r_t + \frac{C_t}{A^{t-1}}$	In a given year "t," the net worth of the foundation sector will decline when the pay-out rate is greater than the rate of return on assets plus the ratio of current contributions to net worth. However, over the long-run, case (3) above will hold.

the foundation sector is not threatened, nor will it be able to grow without limit relative to national wealth.

It would be well at this point to examine the relative magnitude of the parameters we have been discussing. From equation (8'), we can derive the fact that $A_n = \frac{C_1 \cdot g^n}{e-r+p} = \frac{C_n \cdot (1+e)}{e+p-r}$ for large n. Let us assume that case (3) holds. If the rate of growth of contributions equals the real rate of growth of the economy (approximately .04) and if the pay-out rate equals the rate of return on assets, then $A_n = 26 \cdot C_n$. That is, in any given year, the value of the assets held by the foundation sector will be approximately 26 times the value of assets contributed to the sector in that year. As noted in Table 4, if the pay-out rate is greater than or less than the rate of return on assets by one or two percentage points, the relative size of the foundation sector will change. However, the sector's survival is not in doubt, and total net worth remains quite large relative to current contributions.

In summary, a model of foundation-sector growth has demonstrated that there exists a wide range of pay-out rates which allow the government to limit the relative wealth of the foundation sector without in any way threatening its survival, growth, or perpetuity. In fact, the growth of the foundation sector will be primarily dependent upon the growth rate of contributions to that sector. The base for that rate of growth will be affected by the pay-out rate, but, under reasonable assumptions, that base will still be quite large relative to current contributions. Over the long-run, most pay-out rates will limit the net worth of the foundation sector to a fractional share of national wealth. However, the size of that share will still vary with the size of the pay-out rate itself.

Table 4

Net Worth of Foundation Sector Relative to Current Contributions

Pay-out Rate Minus Rate of Return on Assets (p - r)	Rate of Growth of Contributions (e)	A_n as a Multiple of C_n
+.02	.03	20.6
	.04	17.3
+.01	.03	25.8
	.04	20.8
0.00	.03	34.3
	.04	26.0
-.01	.03	51.5
	.04	34.7
-.02	.03	103.0
	.04	52.0

V

THE EFFECT OF DISTRIBUTIONAL REQUIREMENTS FOR FOUNDATIONS UPON THE CHARITABLE SECTOR

Having examined the effects of various distributional rules and pay-out rates upon individual foundations and the foundation sector as a whole, the next step is to take a brief look at their impact upon the efficiency and growth of the broader philanthropic or charitable sector.

Recall that the foundations most severly limited in growth by a pay-out requirement are those for which no new contributions are forthcoming. Therefore, the relative importance of these foundations will decline as the importance of charitable groups receiving new contributions increases. Yet a foundation able to acquire no new contributions is one for which, at the margin, all current charitable givers find its service less valuable than some alternative use of their charitable funds. Therefore, pay-out requirements enhance the efficiency of the charitable sector by encouraging the distribution of funds toward those needs that are recognized by current or recent donors and through organizations where these donors feel that charitable dollars will be effectively spent.

To be efficient, distributional requirements should also encourage foundations to play those distinct roles within the charitable sector that can only be provided by organizations with substantial accumulation of funds. In particular, foundations can provide support for projects requiring a stable source of funds for long periods of time and can meet needs of society when distributions from the rest of the charitable sector decline during recessionary periods. Unfortunately, current distributional requirements discourage these distinct roles by creating too much variation in the amount of required pay-out from year to year. The reforms suggested in Chapter III would correct this situation by leading to a more steady flow of funds which would not decline precipitously in recessionary periods.

As for growth, it must be observed that a decline in asset value for an individual foundation or even for the foundation sector does not necessarily mean a decline in asset value for the charitable sector. Many of the distributions of foundations are made as gifts of assets, buildings, works of art, and so forth, to other organizations and public charities. Hence, it is primarily control of assets (either by donors or through trustees) that is limited by the requirement of a minimum pay-out by foundations. The share of national wealth controlled by the foundation sector may be limited, but the net worth of the charitable sector does not face similar restriction.

VI

CONCLUSION

This paper has examined the history, status, and long-run effects of distributional requirements toward foundations. After presenting a brief historical review of the current law, the paper concluded that any pay-out requirement should meet certain tests of equity across foundations and efficiency in the distribution of their funds. In particular, foundations should not be penalized for conservative investment policies, and neither the pay-out rate nor required distributions should vary much from year to year. To accomplish these goals, (1) foundations should not be required to distribute actual income when it is greater than the pay-out rate times net worth, (2) a consistent relationship should be maintained between the pay-out rate and the long-term real rate of return on an average foundation portfolio, and (3) required annual distributions should be a weighted average of the previous year's distributions and the pay-out rate times current net worth.

With regard to the foundation sector, we have demonstrated that the pay-out rate can be used to limit the accumulation of funds by the sector relative to its current contributions and to limit the share of national wealth held by this sector. There exists a wide range of pay-out rates which will limit this accumulation without threatening the perpetuity of the sector.

Finally, with regard to the broader charitable or philanthropic sector, we noted that a pay-out rate increases efficiency by encouraging distributions toward currently recognized needs of society. However, current pay-out requirements are also inefficient since they encourage distributions to rise in prosperity and fall in recession. As for the growth of the charitable sector, it was found to be even less affected by a pay-out rate for foundations than was the growth of either individual foundations or the foundation sector as a whole.

Footnotes

1. See IRS Code Section 4942 for taxes on failure to distribute income.

2. "U.S. Treasury Department Report on Private Foundations" (Washington, D.C.: U. S. Government Printing Office, 1965).

3. "Foundations, Private Giving, and Public Policy: Report and Recommendations of the Commission on Foundations and Private Philanthropy," (1970).

4. IRS Code Section 4942(e)(3).

5. In Chapter II we deal with the propriety of that particular measure.

6. For instance, nominal yields rose in 1974, indicating an increase in the pay-out requirement for 1975. However, the volatility of most asset markets in that year led Treasury to delay the adjustment that would otherwise have occurred.

7. Commission on Private Philanthropy and Public Needs, *Giving in America*, (1975), pp. 175-176.

8. Aggregate fair market value is based on a montly average of fair market values of securities when market quotations on those securities are readily available.

9. If the pay-out rate were actually based upon the annual "real" return to all assets, the fluctuation in required distributions would be greater, since the value of all assets and the pay-out rate (calculated in part by changes in value of assets) would normally rise and fall together.

10. Stability of pay-out requirements is of course supported by the foundations themselves. For instance, Dr. John Knowles, president of the Rockefeller Foundation, has commented that "the pay-out requirement should be sufficiently stable so that foundations can plan for the management of their portfolios and the development of programs without the disruption of shortrun changes." Hearings before the Subcommittee on Foundations of the Committee on Finance, U.S. Senate, November 24, 1974 (Washington, D.C.: U.S. Government Printing Office, 1974), p. 60.

11. For instance, a 500 common stock price index demonstrates a median "lead" time of 5½ months over peaks and troughs in GNP. See Victor Zarnowitz and Charlotte Boschan, "Cyclical Indicators: An Evaluation and New Leading Indexes, "*Business Conditions Digest* (May 1975), p. XV.

12. Interestingly, revisions (2) and (3) coincide at the margin with the spending requirements devised by Litvack, et. al., for endowment income. Concerned with insuring the perpetuity of an endowment, these economists argue that the ideal spending rule adopted by an institution would "protect the real value of the corpus endowement fund" (i.e., the long-term rate of spending would not be greater than the real rate of return on assets) and "make spendable endowment income . . .relatively stable from year to year." See James M. Litvack, Burton G. Malkiel, and Richard E. Quandt, "A Plan for the Definition of Endowment Income," *American Economic Review* (May 1974) LVIV, p. 433.

13. Since new contributions will not offset D_t in formula(1) or (3), an increase in contributions C_t will require an increase in pay-out equal to $(\beta\alpha)\,\Delta A_{t+1} = (\beta\alpha)\,C_t$.

14. Robert Smith, Pew Memorial Trust, statement before the Subcommittee on Foundations, November 25, 1974, p. 117.

15. Note that if contributions are a stable portion of national wealth, w=e.

FOUNDATIONS AND THE FEDERAL GOVERNMENT: A LOOK AT SPENDING PATTERNS

Michael S. Koleda[†], Daniel Bourque[†] and Randall Smith[†]

Introduction

This report addresses the findings of a comparative analysis of foundation grants and federal expenditures in selected areas for 1973. The work was undertaken at the National Planning Association's Center for Health Policy Studies.

Private philanthropy has historically supported activities, institutions, and purposes generally deemed worthy within the framework of national goals and values but outside the pale of governmental operations. At a time when federal expenditures were both smaller in size relative to GNP and narrower in scope than is the case today, the role of private philanthropy was more easily discernible. As recently as 1930, for example, philanthropic expenditures in support of health and health-related activities nearly equalled the combined expenditures of the federal government's health programs. Today, with the growth during the 1950s of federal outlays for biomedical research and the Medicare and Medicaid financing programs introduced in the 1960s, philanthropic health expenditures have declined relatively to approximately one-seventh those of the federal government. With the advent of some form of National Health Insurance and the growth of a federal presence in all aspects of the health care system that this will imply, the decline in the magnitude of philanthropic expenditures relative to federal outlays in health can be expected to continue.

While perhaps less dramatic than in health, the trend in other areas is much the same. Growth in federal expenditures and the existence of federal programs in nearly all aspects of American social, economic and cultural life has created a situation in which private philanthropy – once distinguishable from federal government spending more by its purposes than its relative financial magnitude – now contributes alongside the federal government as a partner, often junior, in the national pattern of support to areas such as health, education, science, social welfare, and arts and humanities.

Against this background of change, there is increasing desire both from within and without the philanthropic community to describe more clearly the contemporary role of private philanthropic spending in the national pattern of support to these and other areas. In part, this comes from persons within government and the philanthropic sector who wish to see the maximum achieved from the combined effect of public and private expenditures while preserving a pluralistic system supporting a multiplicity of approaches to meeting our nation's social needs.

It is widely agreed that proposals for improving the funding of alternative approaches to meeting public needs, including those that would alter the tax treatment of philanthropic contributions and charitable bequests, must take into account the impact any such changes might have on the magnitude of philanthropic spending in the aggregate and on the national pattern of support to specific areas of interest.

We report here the results of a modest attempt to understand certain aspects of the role of philanthropic spending in six broad areas: health, education, science, social welfare, arts and humanities, and public affairs. The data in the first five of these categories were developed by comparing the expenditures of foundations – the institutional core of the private philanthropic sector – with those of the federal government. No attempt was made to relate foundation outlays to those of the federal government in the area of public affairs since for many functions falling under this title there are no comparable federal expenditures.

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It is worth noting at the outset that in all but one category in which such comparison was made, expenditures of the federal government dwarfed in magnitude those of foundations. With the exception of support to arts and humanities, where foundations outspent the federal government by nearly two to one, foundation grants represented less than 10 percent of comparable federal expenditures.

In using the data presented here the reader should bear in mind several points. The data on foundations are drawn from a sample of grants reported in the Foundation Grants Index and may not be representative of the total expenditures of all foundations since this data base is developed largely through voluntary reporting. The grants sample was allocated to the broad areas noted above on the basis of the information contained in the descriptions of the grants as reported in *Foundation News*. It is likely that more complete information would have resulted in a reclassification of some grants.

Moreover, this comparison of the spending priorities of the foundations and the federal government by selected areas does not distinguish federal spending from foundation spending according to the flexibility, riskiness, stability, or innovative characteristics of that spending. A dollar of foundation support to health research, for example, is perceived for the limited purposes of this comparison as the same as a dollar of federal support.

A more detailed description of the methodology appears in the Appendix.

Table 1

Foundation and Federal Support in Selected Areas, 1973
(in millions of dollars)

	Foundation	Federal	Foundation as a Share of Federal
Health	$ 626	$26,130	2.4%
Education	1,005	13,600	7.4
Science	328	18,300	1.8
Social welfare services	135	10,022	1.3
Arts and humanities	194	108	180
Public affairs	250	n.a.	n.a.

I

HEALTH

Collectively, foundations allocated an estimated $626 million or 31 percent of their budgets to health and health-related activities during 1973. By way of comparison, this was approximately 0.7 percent of national health expenditures, 5.4 percent of state and local health expenditures, and approximately 2.4 percent of federal health outlays. (State and local figures, as reported by the Social Security Administration in Cooper, Worthington, and Piro, "National Health Expenditures, 1929-73," *Social Security Bulletin*, February 1975.) Although small in the aggregate relative to federal spending, the significance of foundation health expenditures becomes more apparent when broken down by activity. For example, federal expenditures for the direct financing and provision of services dwarf those of foundations, reflecting both the relative importance of this activity in the federal health budget and its lower priority for foundations. (See Table 2.)

Table 2

Foundation and Federal Support To Health, By Activity, 1973

	Foundation	Federal
Investment		
Research	$ .10	$ .08
Manpower	.26	.04
Construction	.26	.04
Improving organization and delivery system	.27	.01
Consumption		
Financing provision of services	.04	.79
Prevention control activities	.02	.04
General support to health institution/agency	.05	
Total	1.00	1.00
Total Spending (in millions)	626	26,130

See Appendix for sources.

In other areas the story is different. Health manpower activities and health facilities construction each received 16 cents from foundations for every dollar of federal support, and foundations spent approximately two thirds of what the federal government spent per dollar for projects to improve the organization and delivery system in health.

Viewed another way, foundation expenditures flow toward investment in the health care system of tomorrow and federal outlays toward consumption of services today. This can be seen clearly in Table 2, where projects to build the knowledge base, train health manpower, construct facilities, and improve the organization of care and the efficiency of the delivery system receive approximately 89 cents of the foundation dollar. By contrast, 83 cents of the federal health dollar supports the consumption or delivery of health care services, principally through the Medicare and Medicaid programs of the Department of Health, Education and Welfare.

II

EDUCATION

Based on the definition of education used in computing federal outlays, educational expenditures by foundations in 1973 totalled $1.0 billion or approximately half of total foundation outlays that year. The foundations collectively spent 7 cents on education for every dollar of comparable federal spending. We found that the distribution of the foundation dollar – both by educational level and by nature of the support – differed substantially from that of federal spending.

Specifically, foundations and the federal government were similar in their priorities toward pre-school and adult education, allocating only a small fraction of expenditures to the former and approximately 15 cents on the dollar to the latter.

(See Table 3.) The principal difference in spending priorities was in the support of elementary/secondary and higher education. Federal education outlays were split almost evenly between the two with slightly more going to higher education than to elementary and secondary education. The foundation dollar was overwhelmingly directed at higher education, where the foundations spend 14 cents for every dollar of federal money.

Table 3

Foundation and Federal Support To Education, By Level, 1973

	Foundation	Federal
Early childhood education	$ .02	$ .04
Elementary and secondary	.05	.39
Higher education	.78	.43
Adult and other	.15	.14
Total	1.00	1.00
Total Spending (in millions)	1,005	13,600

See Appendix for sources.

While foundations spent only 1.2 cents for every dollar of federal money on early childhood, elementary, and secondary education combined, the support from these two sources differs markedly by purpose. (See Table 4.) For example, 87 cents of the federal dollar is in the form of direct operational support to institutions. By contrast, almost two thirds of the foundation dollar goes for the training of personnel, the purchase of facilities and equipment, and for education-related research. These three purposes together received 10 cents from foundations for every dollar of federal support.

Tab'e 4

Foundations and Federal Support To Education, By Level and Activity, 1973

	Early Childhood, Elementary, and Secondary Education		Higher Education	
	Foundation	Federal	Foundation	Federal
Operating Support	$ .26	$ .87	$ .09	$ .17
Student Support	.04	.05	.12	.73
Endowment	.06		.18	—
Personnel Training	.22	.03	.07	.01
Facilities/Equipment	.14	.02	.28	.08
Research	.28	.03	.26	.01
Total	1.00	1.00	1.00	1.00
Total Spending (in millions)	70	5,802	784	5,800

See Appendix for sources.

In higher education, foundations spent 14 cents for every federal dollar. Nearly three quarters of the federal dollar is in the form of student support. Direct support to institutions for operations amounts to only 17 cents of the federal higher education dollar. As with the lower education levels, foundations gave greater priority to personnel training, facilities and equipment purchases, and education-related research than did the federal government. Research and facilities and equipment purchases accounted for over half the foundation higher education dollar and less than 10 cents of the federal dollar. Stated alternatively, foundations spent 81 cents for every federal dollar for these two purposes combined.

III

SCIENCE

Foundations spent two cents for every dollar of federal outlays on science and science-related activities in 1973 according to our estimates. The institutional recipients of this support were the colleges and universities, other nonprofit organizations, and certain foreign institutions. Slightly more than two thirds of the foundation science dollar was spent in colleges and universities. By contrast four fifths of the federal science dollar was spent either internally, in industrial firms, or in federally funded research and development centers. (See Table 5.) While the federal government allocated only 13 cents per dollar of its science funds to academic institutions, this still represents better than ten times the comparable amount spent by foundations owing to the magnitude of federal science support.

Table 5

Foundation and Federal Support to Science, By Recipient Institution, 1973

	Foundation	Federal
Colleges and universities	$ .68	$ .13
Foreign institutions	.15	.01
Other nonprofit and other institutions	.17	.04
Federal intramural	—	.28
Federally funded R&D centers	—	.10
Industrial firms	—	.44
Total	1.00	1.00
Total Spending (in millions)	328	18,300

See Appendix for sources

Looking more closely at academic institutions, several differences in the spending patterns of foundations and the federal government emerge. For example, 71 cents of every dollar of federal science support to academic institutions underwrote research and development activities, compared with 19 cents of the foundation dollar. (See Table 6.) A little less than half of the foundation dollar went to train science personnel and slightly more than one third for construction of research and instructional facilities. Together, training and construction activities account for four fifths of foundation science support in academic institutions and less than one fifth of the federal dollar. Within academic institutions, the priority of the federal expenditures is toward funding of research and development projects whereas the foundations place their emphasis on training the scientists and constructing the facilities, spending 27 cents for every federal dollar on the former and $1.69 for every federal dollar on the latter.

Table 6

Foundation and Federal Support To Academic Science, By Activity, 1973

	Foundation	Federal
Academic Institution		
Research and development	$ .19	$ .71
Science personnel training	.43	.15
Construction of research and instructional facilities	.36	.02
Other activities	.02	.12
Total	1.00	1.00
Total Spending (in millions)	223	2,379

See Appendix for sources.

IV

SOCIAL WELFARE SERVICES

Apart from the $77.7 billion of federal outlays for cash benefits to citizens, for which there were no comparable foundation expenditures, the federal government spent $10 billion in 1973 for social welfare services programs – programs in areas such as food and nutrition, housing, employment – and for a variety of programs under the general heading, "social development." Comparable foundation expenditures during this period were estimated at $135 million. (See Table 7.) Stated alternatively, the foundations in 1973 spent 1.3 cents for every dollar of federal money on social welfare services programs. Just under three fourths of the federal money was split almost evenly between food and nutrition programs and programs in social development. The foundations, by contrast, allocated nearly all of their expenditures – 88 cents per dollar – to social development programs. For housing, employment, and food and nutrition programs combined, the foundations spent less than three tenths of one cent for every dollar of federal money. While federal expenditures for social welfare services are better than 70 times as large as those of the foundations, the latter spent 3 cents for every federal dollar on social development, legal aid, juvenile delinquency, drug abuse, alcoholism, services to convicts and ex-offenders, and a variety of other social welfare service programs.

Table 7

Foundation and Federal Support For Social Welfare Services, 1973

	Foundation	Federal
Programs		
Food and nutrition	$ .03	$ .38
Housing	.07	.17
Employment	.02	.10
Social development	.88	.35
Total	1.00	1.00
Total Spending (in millions)	135	10,022

See Appendix for sources.

V

ARTS AND HUMANITIES

Of the broad areas we considered in our comparison of foundation and federal outlays, arts and humanities was the only one in which foundations outspent the federal government.

From the point of view of the type of recipient institution, foundation grants were nearly indistinguishable from federal expenditures. (See Table 8.) The same approximate share of funds from both sources was allocated to museums, state and local governments and associations, and professional performing groups. The principle difference in the allocation of support appeared in the case of educational institutions, where the federal government spent 84 cents for every dollar of foundation support.

Table 8

Foundation and Federal Support to Arts and Humanities, By Recipient Institution, 1973

	Foundation	Federal
Museums and other repositories	$ .27	$ .22
State and local governments, associations and public media	.26	.25
Educational institutions	.22	.33
Professional performing groups	.16	.19
Other	.09	.01
Total	1.00	1.00
Total Spending (in millions)	194	108

See Appendix for sources.

However, when the funds are allocated according to the type of activity supported, the picture is substantially altered. Better than two fifths of foundation support to the arts and humanities was for educational programs and activities. This was more than twice the share of federal funds for this purpose. The foundations spent $3.76 for every federal dollar on educational programs in the arts and humanities. (See Table 9.)

Table 9

Foundation and Federal Support to Arts and Humanities, By Activity, 1973

	Foundation	Federal
Educational activities	$ .44	$ .21
Museum and art galleries	.19	.13
Performing arts	.21	.18
Music	(.10)	(.11)
Theater	(.07)	(.04)
Dance	(.04)	(.03)
Expansion programs	.04	.15
Other	.12	.33
Total	1.00	1.00
Total Spending (in millions)	194	108

See Appendix for sources.

Both sources spent approximately the same share of funds on the performing arts, with music being favored over dance and the theater in both cases.

Apart from share of support to educational activities, the other apparent difference in spending by activity was in expansion programs in the arts and humanities. These programs were given higher priority by the federal government than by foundations, with the former spending over $2.00 for every foundation dollar.

VI

PUBLIC AFFAIRS

Foundations allocated an estimated $250 million to public affairs in 1973, approximately 13 percent of total foundation giving during that period. (See Table 10.) The bulk of this support was distributed among activities directed toward improving the processes and competence of government, clarifying and defining issues of public policy, and ensuring the rights of and participation of all members of society. Since no data were readily available on comparable federal activities, no comparison with foundation support was undertaken for public affairs.

Table 10

Foundation Support to Public Affairs, 1973

	Foundation
Research and communication	$ .37
Training of public service personnel	.10
Civil rights, economic opportunity and public interest	.18
Community and economic development	.20
Other	.15
Total	1.00
Total Spending (in millions)	250

The data presented above contribute to an area in which much more research can and should be done. To the extent that the data are representative of foundations as a whole, they suggest substantial differences in spending priorities between foundations and the federal government, particularly in health, education, and science. As a broad generalization, in these three areas the federal support emphasized consumption of services and the foundation money was biased toward what might be termed investment activities – the support of manpower training, research, construction, purchase of special facilities and equipment.

The social welfare expenditures of the foundations were biased toward a range of service programs while the federal money emphasized the perhaps more basic needs of food and nutrition, housing, and employment. In each of these areas, of course, federal money dominated foundation spending. In the area of arts and humanities, where the foundations outspent the government, the pattern of support by activity appeared less divergent, although foundations placed a much higher priority on educational programs.

Much is said and written about the unique role of the foundation dollar in the national pattern of support in areas of public need. Foundations are subject to different pressures and constraints than is government. There is some freedom, therefore, for foundations to apply different criteria to supporting these areas than does government. We frequently hear that foundation support is in some aspects different from government money, that it is more flexible or innovative. But little hard data exist to support this either as a general statement for all foundations or as more accurately reflective of some foundations or particular programs. As noted earlier, this study does not address such differences between foundation spending and that of the federal government: A dollar of health research support from either source is viewed the same. A more detailed examination of the activities supported might reveal that foundation health research is more likely to flow to high-payoff, high-risk projects and federal money to more conservative projects, but for now any such assertion must remain conjectural.

Appendix

Methodology

This analysis is based on a sample of grants reported in the Foundation Grants Index compiled by the Foundation Center. The sample consisted of 4,954 grants reported in 1973 with a combined dollar value of $463 million. This represents approximately 65 percent of the total dollar amount of grants reported in the Index during 1973 and more than 20 percent of total foundation giving during that year, estimated at $2.0 billion in 1973 by the American Association of Fund-Raising Counsel, Inc. Relying for its data on voluntary reporting by foundations of grants over $5,000, the Foundation Grants Index tends to be biased toward larger foundations. Nonetheless, it is the most comprehensive source of detailed information on individual grants available. Sources of federal outlay data included the Office of Management and Budget, the Social Security Administration, the National Science Foundation, the National Endowments for the Arts and Humanities, and the National Planning Association.

The sample of grants was distributed to categories so as to be comparable with available data on federal expenditures in the areas of education, health, science, social welfare, and arts and humanities. The distribution of the sample by area was then taken to be the AAFRC estimate for total foundation giving in 1973, by area.

It is important to note that the categories for gathering data overlap. The fact that some federal outlays were allocated to two or more categories resulted in double or even triple counting. For example, outlays of the National Institutes of Health for fiscal year 1973 reported by the Office of Management and Budget under Education, Health and Science totalled to more than twice the budget of the Institutes. (More specifically, NIH support for training of biomedical researchers could be classified under all three of the above titles.) In order to construct foundation totals by area in a manner that would allow for comparison with federal spending patterns and priorities, a single foundation grant was sometimes allocated to more than one area. As a result our totals for foundation giving by area differ from those reported by the AAFRC in *Giving USA*, where the foundation dollar is reported in non-overlapping categories.

Sources of Data on Federal Expenditures

Table 2

Data on federal health expenditures were taken from a recently completed study performed at the Center for Health Policy Studies of the National Planning Association: L. Russell, D. Bourque, C. Bourque, C. Burke: *Federal Health Spending, 1969-74*.

Tables 3 and 4

Federal outlay data in this area were drawn from Analysis H of the *Special Analyses, Budget of the U.S. Government, Fiscal Year 1975*, Office of Management and Budget.

Tables 5 and 6

Two major reports periodically compiled by the National Science Foundation provided the data on federal science expenditures. The first report, entitled *Federal Funds for Research, Development and Other Scientific Activities, Fiscal Years 1972-74* estimated federal obligations for R & D, R & D plant, and other scientific activities at $17.8 billion in fiscal 1973. The second report, *Federal Funds for Academic Science, Fiscal Year 1970-71* estimated federal support to academic institutions at $2.5 billion in fiscal year 1973*, about one-half billion dollars higher than the comparable estimate in the first report cited above. The difference between these estimates was due primarily to the inclusion of funds for science personnel training and other science related activities. An estimate of total federal science support of $18.3 billion in fiscal 1973 was developed by integrating the figures in the two reports.

*Figures for fiscal year 1973 were obtained from the National Science Foundation.

Table 7

Data on federal social welfare expenditures were derived from Social Security Administration estimates compiled annually: Alfred M. Skolnik and Sophie R. Dales: "Social Welfare Expenditures, 1972-73," *Social Security Bulletin,* January 1974. These outlay data were reorganized to exclude health and education expenditures, and to break out cash payments from welfare benefits in the form of services (in-kind benefits).

Tables 8 and 9

Data for the National Endowments were extracted from the Annual Reports of each organization for fiscal 1973. Data for other organizations were derived from the *Appendix to the Budget of the United States Government, Fiscal Year 1975,* Office of Management and Budget, Washington, D.C. These include: National Gallery of Art, Woodrow Wilson International Center for Scholars, Smithsonian Institution, John F. Kennedy Center for the Performing Arts, Battle Monuments Commission, Bicentennial Commission, Commission on Fine Arts, Commission on Highway Beautification (Department of Interior).

COMMUNITY FOUNDATIONS

Norman A. Sugarman†

I

BACKGROUND

A Brief History of the Community Foundation Movement

The community foundation movement began in the United States in 1914. The concept of the "community trust" originated with F.H. Goff, then president of The Cleveland Trust Company.[1] Goff was concerned with the "dead-hand" restraint on charitable funds imposed by deceased donors and maintained under the traditional legal concepts that testamentary charitable trusts are to be used solely for purposes specified by the testator, except when a variance is permitted under the *cy pres* doctrine. Under this doctrine, if a court finds that the originally specified purpose is impossible to accomplish, it may select another charitable purpose which it determines is most closely related in kind to that specified by the donor.

The dead-hand control by the donor and the limitations – as well as the delay and expense involved – in the application of the *cy pres* exception motivated Goff to propose that the donor, in funding a charitable trust, agree at the same time that if, by reason of changed conditions, his original specification of charitable use becomes obsolete, a responsible group of citizens be authorized to order a diversion to more widely beneficiary purposes.

The "Cleveland Plan," as Goff's proposal came to be known, also provided additional protections for charitable funds by dividing their administration so that investment responsibility was lodged in a professional corporate trustee serving in a fiduciary capacity and the power to make charitable distributions and vary charitable uses was lodged in a distribution committee. The distribution committee is chosen to represent the broad interests of the community to assure that charitable distributions from the endowment are made by persons who are knowledgeable and experienced as to community needs. To engender confidence in the integrity and independence of the committee on the part of potential donors and the public, the Cleveland Plan provided for its selection by public officials, such as federal and state judges, and individuals acting in their institutional capacity, such as presidents of universities, bar or medical associations, and similar organizations. Over time, the charters of some community foundations sought the same end using other methods for selecting members of the distribution committee. See p. 1693.

The genius of this plan is that it provides to testators or donors the stability of professional management of charitable funds and the continuity that could be expected from such management in a bank or trust company as the corporate trustee; at the same time, it provides assurance that while the donor's charitable directions will, so long as they are beneficial, be honored under fiduciary concepts governing a trust, the charitable uses and purposes will not be rendered obsolete or harmful, since a responsible group of community leaders will be in a position to exercise their best judgment regarding the beneficial use of such funds in the events of changed conditions. All of this would be accomplished without the delays, expense, and possibly narrow limitations that would be involved in the only other legal alternative, that is, application to a court for exercise of the *cy pres* doctrine. From the standpoint of a testator or donor who has an interest in the community and also a desire to have a permanent, meaningful memorial in the form of a perpetual chairtable fund, the community-trust concept could and did prove very attractive.

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The original concept of the community foundation related only to *testator's* gifts. The mechanics involved a bequest to a bank as trustee, with the contributed property to be held and administered under the "declaration of trust" of the bank which established the community foundation with terms as described above. Because the community foundation was conceived of as a vehicle for receipt of testamentary gifts it was slow to develop; and, of course, it had to prove its usefulness before it became more acceptable as a method for charitable giving by persons of means.

Since the community-foundation concept originated with a banker and with emphasis on following fairly traditional concepts of trusts, with a bank or trust company as trustee, the community-foundation movement for many years consisted almost entirely of community trusts formed on the Cleveland Plan.

It was inevitable that because the concept was that of a trust for the *community*, other banks in the same community would seek to participate as trustee of a community foundation originated by one bank in the community and that a group of banks in some communities would agree to form a community foundation with a number of banks as participating trustees. Thus the pattern that developed in many communities was of multiple bank trusteeships of community foundations.

However, as the community-foundation movement spread throughout the country, other variances took place. In some communities groups of civic leaders conceived of organizing a community foundation in corporate form, with arrangements whereby the corporate community foundation would either manage its own investments or would, by agreement, authorize investments to be held and administered by local banks. Another variance was adopted in a few communities in which a corporation was formed to perform the functions of the distribution committee and to act in association with a corporate trustee, which received and invested community trust funds under a declaration of trust.

Just as variances developed in the form of community foundations, it was inevitable that differences would develop in the geographic scope of such foundations. Although the community-foundation concept was initially built upon serving public needs in administering charitable bequests of testators in the community, the emphasis on "community" brought to the fore the concept of the community foundation as an endowment fund primarily to meet the needs of a particular community or geographic area. While community foundations flourished in large cities like Cleveland, Chicago, New York, and San Francisco, the Cleveland form was also copied in smaller communities. However, as the concept of an endowment fund for community needs developed and as the idea became of greater interest to civic-minded persons in various walks of life, a broader geographic base had to be considered. The Rhode Island Foundation, which in 1973 had an endowment of $16 million, was founded in 1921. In New Hampshire, a state with a comparatively sparse population and with a good highway system promoting easy access and communication, a statewide community foundation was established in corporate form in 1962. The concept of the community foundation for a state has similarly been put to use in other states. Likewise, as metropolitan areas have grown, community foundations in small communities have found it more difficult to carry out their purposes efficiently, and the community foundation as a regional concept has become more attractive.

In smaller communities which have traditionally relied upon funding from bequests (which is at best sporadic), growth of community foundations has been particularly slow. In some areas, community foundations have also been slow to grow because the original impetus (as in Cleveland) stemmed from the banking sector of the community, but (unlike in Cleveland) other leaders in the community did not take up the idea and actively support the community foundation as an important vehicle for community funding.

The strength of the community-foundation movement lies in the recognition by persons in all sectors of the community that there is a great advantage to th community's having an endowment fund for community needs and that the community should therefore provide a proper vehicle for this purpose, one that will enable persons of means to leave their funds to be used in the community primarily for the benefit of the community, rather than having their funds dispersed by investment and used in areas outside that in which the funds originated. The community foundation is conceived of as a proper vehicle for encouraging people who made their money in a community to return part of it to that community by adding to an open-ended endowment to meet community needs.

Community foundations differ from the United Way and similar funding groups in that they do not solicit annual gifts for specific charitable and social welfare agencies. Rather, they seek primarily to attract bequests and larger inter vivos gifts to be applied over the long term to a broad spectrum of community needs. The separate roles that community foundations and united funding groups fill in meeting community needs were well delineated in a 1956 speech by Ralph Blanchard, then executive director of United Community Funds and Councils of America, Inc., in which he noted:

> . . . Although the possibility of acquiring endowment funds might seem attractive to Chests at first glance, there are inherent dangers which outweigh the apparent benefits. The building up of such funds might give a false impression to annual Chest givers of the amount of money that is available for operation. As a result there may be a tendency on the part of contributors to reduce their gifts in the belief that the Chest has more funds at its disposal than is actually the case. Publicizing sizeable reserves at the disposal of the Chest can have serious consequences in a campaign; hence Chests are reluctant to give out such information.
>
> The holding of capital funds by Chests is not necessarily most desirable because of the probable necessity of using these funds to supplement the regular budgets of members agencies. The money would thus be used for current operations at the expense of forward-looking projects in research or experimentation. Both endowment funds for future benefits and current funds for operating expenses should play a vital role in financing communal enterprises, but it would seem best not to mix the two in a single organization. In addition, foundations set up and operated by Chests probably produce less money from donors than do independent foundations . . .
>
> Community foundations constitute ideal partners for Community Chests and United Funds in rounding out the financing picture to the end that private health and welfare agencies may continue to play the vitally important role which they must maintain in the total American health and welfare picture.

Some Basic Data on Community Foundations

Statistics as to the size of community foundations, from the Council on Foundations and the Foundation Center, indicate that in 1973 the nearly 250 community foundations in the United States and Canada had assets of almost $1.15 billion and made grants of approximately $60 million.

There is evidence of substantial community foundation growth in the period since enactment of the Tax Reform Act of 1969. The estimated assets of community foundations grew by 30 percent from 1970 to 1972 and another 10 percent in 1973.[2] The report of the Council on Foundations to the Filer Commission (August 1974) indicates that a portion of this increase came from the termination of private foundations. Data furnished by some 60 community foundations for a 1973 Council on Foundations survey of contributions to community foundations indicated that 46 percent of the $40 million in recent gifts to these foundations came from private foundations. In another survey, 20 community foundations indicated that between

January 1, 1970, and mid-1973, they received assets of 91 dissolving private foundations, with the transferred assets having a market value in excess of $60 million.[3]

Appendix A is a current list of the community foundations in the United States. It suggests the wide geographic range and the variety in the size of communities that have created them. Table B-1 (Appendix B), which is based on 1970 data, provides a breakdown of community foundations by asset category, and indicates that those with a $1 million or more in assets – just over one-quarter of all community foundations – account for better than 95 percent of total community foundation assets. Based on reports for 1973, usually the most recent year of record, there are about 70 community foundations with assets exceeding $1 million, accounting for more than $1 billion in total assets. Community foundation asset values have undoubtedly diminished in the face of current economic conditions, and this will be reflected as 1974 year-end data become more fully available. However, primarily because community foundations can and do attract new funds, they are much less likely than private foundations to have to make significant grant cut-backs.[4] Table B-2 (Appendix B) lists those community foundations currently reporting assets in excess of $10 million. Table B-3 (Appendix B) shows the proportion of community foundation grants by region, according to 1970 data. Distributions by community foundations are discussed in more detail in Chapter II.

Characteristics of a Community Foundation

While the foregoing brief history indicates that community foundations evolved from a variety of circumstances, these foundations nevertheless have certain distinct characteristics which set them apart from other forms of philanthropic institutions. The following are the typical and traditional characteristics of a community foundation:

1. *A community foundation may be organized in trust form, in the form of a not-for-profit corporation, or a combination thereof.* As previously indicated, the oldest form of community foundation is created under a declaration of trust with a bank or banks as corporate trustees and with a distribution committee composed of representative citizens having power to distribute the income produced from the assets held in trust. A contribution may be held in a fund of such a community foundation, indentified by the name of the donor, or in a general fund of the foundation; but in either case the gifts in trust are a part of the community foundation and subject to the ultimate authority of the distribution committee. More recently, community foundations have been created in corporate form, in which case the governing body of that corporation may itself manage both investments and distributions or it may involve participating or cooperating banks in the investment function by having them serve as trustees, agents, or custodians. In a few instances, community foundations have been formed with an incorporated distribution committee and with banks serving as participating trustees, so that the association of such corporation and trustees constitute the community foundation.

2. *It is organized to serve as a community agency or resource.* The community foundation is a vehicle for different persons in the community to combine their charitable gifts and bequests to support charitable projects in the community. It also permits charitable funds donated in the past to be reallocated among those charitable organizations that are able to perform the services most needed by the community at any particular time.

3. *It is designed to attract gifts and bequests from many persons in the community.* Although it seeks both large and small contributions, it does not compete with local annual fund raising organizations, such as community chests and united funds which

pay out the funds collected each year. Rather, the community foundation seeks capital or endowment funds to meet short-term and long-term needs of the community. It seeks its funds by working through banks, attorneys, and other professional people, as well as through communitywide programs calling attention to the community foundation as a recipient of gifts and bequests for the benefit of the community.

4. *It administers charitable gifts and bequests in a fund or funds under the direction of responsible and representative persons.* The dual nature of the responsibility for operations is a unique aspect of the community foundation – which is part of its appeal to donors as well as a basis for its public-service role. *Distribution of funds* is the responsibility of the governing body (or distribution committee). Terms are provided for turnover of the membership of this body, and its members are periodically selected by a variety of responsible and representative persons or organizations in the community, such as judges, educational institutions, county welfare associations, or upon standards that insure attention to the wide range of the community's charitable needs. Over a period of time various methods have evolved for selection of the distribution committee or other governing body. A number of different methods are employed to make the governing body representative of the varied interests in the community.[5] For example, in New Hampshire, the New Hampshire Charitable Fund has a membership that is required to be geographically representative of the state; the membership elects the governing body which in turn is required to be representative of the various interests, both geographic and other, throughout the state.

Investment of assets of the community foundation is generally the responsibility of banks or trust companies in the community. This division of labor permits both distribution and investment functions to be performed by bodies that have the greatest expertise for their jobs.

5. *The governing body of the community foundation acts in a fiduciary capacity and without being restricted or stifled by the "dead hand" of the donor.* As indicated above, one of the primary advantages of a community foundation is its power to utilize gifts in trust for current community needs. Gifts and bequests are accepted for unrestricted purposes or for the benefit of a particular charitable purpose or organization (provided such use is consistent with the charitable purposes of the community foundation); but all gifts and bequests are subject to an overriding power in the governing body to cause a variance in their use if a specified use becomes impractical, impossible of fulfillment, or if a variance is necessary or desirable to implement the charitable purposes of the foundation.

6. *The community foundation operates for charitable purposes.* It functions exclusively as a vehicle to provide support for the conduct of charitable institutions or objectives primarily in the geographic area that it serves. It normally distributes all of its net income within the year realized or the next year. It serves as a supplement for local charities in need of additional funds for special projects and programs and also initiates activities on its own.

7. *The community foundation is operated primarily for the benefit of the community.* This characteristic is unique to the community foundation. The area in which it operates may comprise a town or city, one or more counties, or even an entire state. This permits the endowment funds dedicated to charitable purposes to focus on solving the problems of an entire area. The community foundation is a suitable vehicle for a donor or testator who wants to benefit his community or area but is uncertain as to what the future needs of the community will be.

8. *The community foundation is accountable and responsible to the public.* This is another reason for public confidence in the community foundation. It is a

long-standing practice among community foundations to render an annual accounting and report to the public. In this way, the public can see how funds are being applied and what projects are supported by the foundation. Accountability and responsibility are immediately enforced on community foundations by their obligation to continually seek additional funds. This responsibility is discussed at length in the following chapter.

II

THE ROLE OF COMMUNITY FOUNDATIONS

Operations of Community Foundations in General

Structure for Attraction of Gifts or Bequests from the Public

In viewing the operations of community foundations, a proper starting point is recognition that the community foundation is structured so as to attract gifts and bequests from the public. The organizational structure is such as to gain public confidence, with regard to the security of funds and their distribution for charitable purposes. Under the Cleveland Plan, the structure was designed to inspire public confidence based upon the role of the bank, as the guardian and investor of the funds, and the selection of the members of the distribution committee, primarily by appointment by various public officials. Recently, many communities have found that public confidence can be obtained by structures that provide for a broader participation or representation in the apparatus of the community foundation and that attractiveness to donors is developed through the reputation of persons who serve on the distribution committee (or the governing body) and through the good experience of others in connection with the community foundation. In some communities a combination of these factors may be employed to make the structure attractive to donors. Thus, in New York there are two entities; the New York Community Trust, which is based on the Cleveland pattern, and Community Funds, Inc., which is a corporate community foundation with which the banks have no special role. The reason for and use of these two entities is that the New York Community Trust is operated in the traditional form , but only for gifts that are large enough to be held and administered as separate trust funds by participating banks, while Community Funds, Inc., will accept smaller gifts. The investment vehicle is kept simple; funds are placed in a savings account or in a mutual fund, depending on which is more appropriate for income or growth under the circumstances.

Efforts to Seek Public Support

Community foundations reach out to the community to seek gifts or bequests. Here the traditional role of these foundations is that of a "soft-sell" approach; for the community foundation, as an endowment-type organization, is seeking capital funds and does not want to interfere with the annual fund drives of other organizations. Thus, community foundations tend to reach prospective donors by informing lawyers, trust officers, accountants, and other professional advisers who are in a position to recommend gift programs to donors and through the good will developed by projects, published reports and other literature, and word-of-mouth reports from satisfied donors. In recent years community foundations have more often used public meetings and the press, radio, and television to tell their stories.

In some communities the role of banks in the development of community foundations is particularly important. Obvious benefits can accrue to a community foundation from the interest of trust officers in encouraging individuals to make gifts or bequests in trust under the declaration of trust of the community foundation. Regardless of the form of the community foundation, banks can serve an important role, not only as trustee or agent for investing charitable funds, but also in advancing the public interest in the development of the foundation. However, the development and growth of community foundations depends, in the final analysis, upon a broad base of community support, impetus for which should come from varied segments of the community's leadership.

Types of Gifts or Bequests Encouraged

The third aspect of the operations of a community foundation involves translating general public support into the act of a specific donor making a gift or bequest to the foundation. In this connection, one of the most important functions of the community foundation is to educate would-be donors, lawyers and other advisers as to the proper form of gift to be used.

An important development in the community-foundation movement has been the trend away from restricted gifts of donors. Originally, donors were attracted to making gifts to community foundations on the concept that their specific designations in the instrument of gift would be followed unless, due to changed conditions, the distribution committee ordered a variance. Now the emphasis is on unrestricted gifts, so that the distribution committee will have a freer hand to use the income from endowment funds for current community needs. This does not prevent the donor from specifying an area of charitable interest, such as support of educational institutions or meeting health needs in the community, nor does it prevent community foundations from seeking additional gifts by establishing special-purpose funds in the foundation to which donors may be attracted to contribute (such as funds for medical research or advancement of education, library funds or scholarship funds).

Another important development is the effort by some community foundations to obtain special gifts for funds for internal purposes, that is, to have funds that may be used to cover administrative costs (employ staff or reduce overhead charges on other funds), to conduct research, or to initiate community programs to be conducted by the foundation or by other organizations.

These developments are more fully discussed later in connection with the distribution and grant programs of community foundations.

Investments and Distributions

Two prime aspects of the operation of community foundations involve the administration of their investment and distribution programs. Here, of course, procedures will vary depending upon the form of the community foundation; but fundamental concepts will not necessarily vary because of the presence of basic fiduciary concepts in the investment of funds for charitable purposes and in the distribution of funds (generally, income) for charitable purposes.

As previously noted, where a designated fund is large enough, it may be invested separately; but frequently, funds of community foundations are invested in common because of the savings in costs and the benefits of diversification in the investment of larger funds.

Distributions by community foundations are made under several different procedures. In the case of funds that are for specified purposes, such as to distribute the income to a local environmental agency, distributions are made to named grantees, subject to the responsibility of the distribution committee to assure that the grantee continues to fulfill its charitable functions. In the case of funds for general or unrestricted purposes or for grants within a program field, such as education, distributions are made at the direction of the distribution committee, based upon proposals made to the distribution committee and analysis and recommendations generally prepared for the distribution committee by the staff of the community foundation. Advisory committees may also make recommendations as to distributions from some funds, with the distribution committee having final authority.

Almost all community foundations go through a period when yield from endowment is insufficient to engage staff. During this stage, they are dependent upon the commitment of time, talent, and energy of volunteers, primarily distribution committees that serve pro bono. Community foundations without staff tend to emphasize grants for the general support of established agencies and institutions.

If they have been founded in an area with sufficient population and resources and if their leaders and the community stick with them through these leaner years, community foundations will, over time, engage staff, likely part-time at first. As they get full-time staff, and it grows, their grant programs tend to be more resourceful and to serve a wider range of community needs. The growth process is well exhibited by the Hartford Foundation for Public Giving, which this year (1975) is celebrating its 50th anniversary. At the end of 1973, it had more than $40 million in endowment and in 1974 it distributed $1.4 million, responding to the full spectrum of community needs. In its first 10 years, however, it was not large enough to make a grant.

All of the larger community foundations, such as Cleveland, New York, Chicago, San Francisco, and many others with much more modest endowments have staffs that are capable not only of analyzing proposals made to the foundations, but in acting as a positive factor in developing projects for the community which will make meaningful use of funds available from the community foundation and other resources. As shall be discussed later, the size of the community foundation and the role of its staff are important in suggesting how these foundations might be better organized to meet community needs on a broad level.

Staff and distribution committees attempt to attract funds to community foundations that are subject to grant discretion by the foundation's governing body rather than being limited to designated charities or narrowly restricted charitable purposes; for, over time, there has been increasing recognition that the community foundation's unique value to the community can be realized more fully as its staff is able to relate funds to newly perceived needs.

Nevertheless, a community foundation achieves its purpose by accepting various kinds of funds, including "donor advisory funds." These funds, which may be given various designations by community foundations, are unrestricted funds for which donors during their lifetime have the privilege of making recommendations – not directions – for charitable distributions within the community foundation's purposes. The authority to accept or reject such recommendations resides in the governing body of the foundation. This type of fund has the advantage of control by the community foundation but also provides for a continuing relationship with the donor, thereby maintaining his interest in the foundation with a view that over the years he will add to the funds that he has established. Such funds, of course, are almost entirely a function of lifetime gifts by donors, as distinguished from bequests. They reflect the incentives provided to donors by the tax laws to make lifetime gifts because of the income tax savings resulting from such gifts. Thus, the trend in community foundations is to invite more lifetime giving, to maintain a continuing interest by donors to add to charitable funds created during lifetime by making bequests under wills, and to attract funds that are undesignated and, therefore, subject to the broadest discretion of the distributing directors.

The Role of Community Foundations in Community Public Service

Community Foundation Distributions in General

Table B-4 (Appendix B) shows the field preference for community foundations compared with general grant distributions by all foundations (1972-1973). It indicates that community foundations spent approximately 60 percent of their grant dollars for welfare and health pruposes, which is a substantially higher percentage than that for all foundation grants (34 percent). While community foundations also made substantial grants to education, this field ranked third with community foundations as compared with a ranking of first among foundations generally. While care must be taken in generalizing from the figures in Table B-4 it can be reasonably concluded that the "community" orientation of community foundations comes through quite clearly in such data.

Uses of Community Foundation Grants

As previously indicated, the community foundation is a community resource for community projects and programs. However, it is not merely a grant-making organization: it can be a positive factor in efforts to develop and accomplish community goals and solve community problems. Such efforts were among the first activities undertaken by community foundations, for example, the study of the criminal justice system in Cleveland undertaken by the Cleveland Foundation in 1920. Similar efforts have been undertaken by other community foundations and today are an important and unique function of the foundation. The fact that the community foundation is perceived as an independent, unbiased third party by many in the community makes this role particularly appropriate. Often the community foundation is perceived as the *only* mechanism for sponsoring such studies, particularly on more controversial issues.

This role of community foundations may take various forms and may be variously described. The following examples are illustrative of current efforts of community foundations in public service:

- When, in 1972, proposed changes in federal regulations threatened to cut off government grants to day care and other service agencies, the San Francisco Foundation's endowment provided a margin of safety for the community. It joined three other Bay Area foundations to set up a Community Emergency Fund of $360,000 to respond to applications of agencies that would need time to adjust to the shift in federal procedures. The $250,000 committed by the San Francisco Foundation, together with $110,000 from the three private foundations, has been allocated in grants and loans to save worthwhile agencies, to ease their cash-flow problems, and to give them time to develop new constituencies and other sources of funding. A committee which includes representatives of the participating foundations and United Bay Area Crusade passes on grants to the agencies that are in need of help.

- In 1972, Winston-Salem's PTA Enrichment Project, a school-curriculum-related program designed to match principal/teacher/student needs with community resources, was threatened with extinction at the end of its initial six months funding period under the Emergency School Assistance Programs of HEW. Interim support from the Winston-Salem Foundation enabled the project to continue its education-enriching activities affecting some 50,000 students until new federal funds could be secured the following year under the Emergency School Assistance Act.

- Endowments of community foundations have also provided local service agencies with a central source of capital to build or remodel new facilities. Evidence of this role is to be found in the annual report of almost every community foundation, including that in 1973 of the Hartford Foundation for Public Giving. Among other grants it reported were $20,000 toward the cost of additions to the West Hartford School of Music, $25,000 toward the cost of restoring Grey Lodge – Shelter for Women, and $66,000 toward the cost of installing and equipping a new 10-bed post-coronary care unit for San Francis Hospital. A 1970 study of its sister community foundation in neighboring New Haven showed that it had over many years followed the pattern of other community foundations in making grants for capital items, such as additions to the truck fleet of Goodwill Industries and new automobiles for the visiting nurses associations and other agencies in the community. It is not uncommon for community foundations to come to the rescue of charitable services when the roof begins to leak, the boiler dies, or another capital item gives out.

- Community foundations are also a source of uncommitted funds without which the community would find it more difficult to respond to newly perceived needs. The need to preserve open spaces and natural areas has always been with us; but public perception of that need has reached a new height in recent years. In many communities, no environmentally oriented service agencies exist to respond to the need, or if they do exist, they cannot find money beyond that needed for annual operations for such a purpose. Recognizing such needs in their communities, the New Hampshire Charitable Fund recently established a natural-area acquisition fund, and the Chicago Community Foundation in 1973 contributed to a fund with a like purpose. From these funds, money is borrowed or granted private and public environmental agencies to purchase, as they come on the market, natural areas that are better preserved for public use than subjected to other kinds of development.

- And in a similar vein, the New Haven Foundation, working with the New Haven YWCA and the Connecticut Department of Corrections and others, is helping to translate the idea of community-based residential facilities for criminal offenders into a working reality at the local level. A substantial grant in 1973 of $57,000 to the "Y," coupled with assurances that the State of Connecticut would assume future financial responsibility if the project proved out, enabled the "Y" to become one of the four planned group homes to accept, after careful screening, selected inmates from the state's female correctional facility at Niantic. The foundation has a significant role in the planning and evaluation of the project, as well as providing dollars. It sees the project as furthering a variety of goals – helping to change and improve the Connecticut corrections system and reduce its costs; providing a model for similar projects throughout the nation; constructively affecting public attitudes towards offenders; and allowing further research and development of community-based rehabilitation techniques.[6]

The role of the community foundation in serving as a catalyst for evaluating community problems and augmenting available services dealing with those problems is well illustrated by recent projects:

- In 1972, The Cleveland Foundation's Youth Program Development Project assisted in the development of some 225 summer-time neighborhood programs under a broad master plan that resulted in employment of 12,000 young people, daily meals for 12,500 youngsters, and bus trips for 3,500 youth and 800 elderly. These programs, affecting the entire metropolitan area, were funded primarily by meshing some $500,000 in funds from at least 8 local foundations with $7 million available from a wide assortment of federal funding sources.[7]

- ASPIRES, the acronym for "A Science Program To Improve Reading Through Environmental Studies," supplements the Hartford Connecticut School Department's limited budget for science instruction and contributes to its efforts to improve reading levels of youngsters in grades three through six throughout the city's public school system. Supported by a three-year $50,000 grant made in 1974 by the Hartford Foundation for Public Giving, classes in astronomy, ecology, and geology are carefully planned to utilize the stimulus of the sciences to improve basic reading and writing skills. An evaluation component is built into the grant so that changes in reading achievements and habits over the grant period can be studied and measured. Four other school districts are considering or have already adopted similar programs.

- An initial grant of $25,000 by The Lincoln Foundation (Lincoln, Nebraska) helped its community undertake a comprehensive effort to deal constructively with drug problems on a countywide basis. The grant produced a coordinating mechanism that provides guidance to all community agencies active in the field. The grant also played a catalytic role in spawning a series of programs: statistical research to help identify and quantify the extent of the problem; a referral service, the costs of which are met by federal and local funds; a drug analysis center; and new approaches in drug education for youth and adults.[8]

While nongovernmental service agencies tend to be the principal beneficiaries of community foundations, in fulfilling their mission community foundations often make grants to governmental units. In its 50th-year report, the Grand Rapids Foundation highlighted such a grant of $9,450 to the City of Grand Rapids for a communication system to "tie the city's four major hospitals together in an emergency medical care and cardiac program."

Often a community foundation provides the initial support for a community program in agreement with United Way, Catholic Charity, or a similar umbrella organization by making a grant declining in amount over three to five years. This use of the community endowment enables a program to get under way and sustains it until the umbrella organization can gradually absorb its continuing operating support. An illustration is the three-year $60,000 grant to Community Service Society by the New York Community Trust in 1974 "to help establish a friendship center for the mentally frail elderly on the Lower East Side, Manhattan."

Often a community foundation acts as a stakeholder for activities that contribute to community betterment. Donors may be reluctant to contribute to the endowment of an agency whose services they value but whose capacity to manage endowments they doubt. Such individuals give their funds to the community foundation to be used for its desired purpose. Similarly, some donors consider it safer to give the community foundation title to the real property that is to be used by an operating agency for its program, since the former is likely to endure even though the operating agency later falls on hard times. The Winston-Salem Foundation, for example, has held title to a municipal fairground and its 9,000-seat auditorium, YMCA and YWCA buildings, and a community building housing the United Way and a number of other charitable agencies.

The above are examples of varied and imaginative services by community foundations for the betterment of the communities they serve. There are, of course, numerous other examples, but they would only be repetitious of the same point – namely, that community foundations serve a unique role in providing not only support but necessary services in meeting community needs.

Community Foundation Services in Utilizing Other Community Resources

Another aspect of the role of the community foundation is to serve as a resource for other charitable organizations in the effective use of their own grant programs. The Hartford Foundation for Public Giving, the Chicago Community Trust, and

Boston's Permanent Charity Fund have joint service programs in their communities. Community foundations such as the Cleveland Foundation and the New Hampshire Charitable Fund maintain regional collections of the Foundation Center. The New York Community Trust sponsors a regular series of luncheon meetings for foundations emphasizing local grants to fill needs in New York City; similar groups have been developed in Winston-Salem, San Francisco, and Cleveland. Community foundations make their information with regard to community needs and their evaluation of grantees' programs available to other grantors in the community, including private foundations, bank trust officers, and the like. All of these services are part of the role of the community foundation in providing philanthropic leadership as a community service. This role will be discussed further in Chapter IV in connection with the future role of community foundations.

III

COMMUNITY FOUNDATIONS AND THE TAX LAWS

Pre-1970 Status of Community Foundations Under the Tax Law

Community foundations have long been recognized as operating for tax exempt charitable purposes; in fact, section 501(c)(3) and its predecessor statutory sections have expressly recognized "community trusts, funds or foundations" as exempt charitable organizations.

Attention was focused on the precise nature of a community foundation for income tax purposes as the result of legislation enacted in 1964. The 1964 act expanded the category of charitable organizations qualifying for gifts deductible up to 30 percent of a donor's adjusted gross income (as distinguished from the 20 percent limit otherwise generally applying) by the addition of section 170(b)(1)(A)(vi) of the Code, reading as follows:

> (vi) an organization referred to in subsection (c)(2) which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from a governmental unit referred to in subsection(c)(1) or from direct or indirect contributions from the general public.

Treasury Department regulations issued under this provision of the statute prescribed two tests for determining whether an organization qualified as a "publicly supported organization"; one test was the "mechanical test" and the other was a "facts-and-circumstances test." It was recognized in the development of these regulations that community foundations were not likely to be able to qualify under a mechanical test which required that at least one third of the support of the organization normally be derived from current contributions from the public or the government. However, it was also realized that community foundations are by their nature publicly supported organizations; but by reason of their traditional reliance upon bequests and the acquisition of endowment funds, their current support could be sporadic and their investment income could be substantial. Accordingly, the facts-and-circumstances test became the basis for the classification of community foundations and certain other types of organizations as "publicly supported organizations." In fact, the regulations delineating the facts-and-circumstances test gave examples of community foundations that met such tests. The basic concept of the facts-and-circumstances test was that without satisfying a mechanical rule for current public support, an organization could nevertheless be regarded as a publicly supported organization based upon a number of factors, such as a program to attract public support, a publicly representative governing body, publication of annual reports, and related factors.

The principal value of the regulations issued under section 170(B)(1)(A)(vi) lay not only in this recognition of the community foundation as a "publicly supported organization" but in the fact that, by the examples given in the regulations, a community foundation in trust form was recognized as an "organization" or entity for tax purposes, rather than each trust or fund of the community foundation being treated as a separate organization. Both of these concepts became of major importance under the subsequent Tax Reform Act of 1969.

Classification of Foundations Under The 1969 Act; Application of Rules to Community Foundations

Congress in the 1969 act did not change section 170(b)(1)(A)(vi) of the Code, which was the basis for the classification of community foundations as publicly supported organizations. Indeed, the first classification of public charities, under section 509(a)(1) of the Code, merely picks up section 170(b)(1)(A)(i)-(vi); and, therefore, it is arguable that Congress intended no change in the classification of organizations that would be treated as publicly supported organizations under the regulations prior to the 1969 act. Nevertheless, the Treasury Department has taken the position that the greater importance of public charity classification engendered by the 1969 act required a reexamination and clarification of the tests under the prior regulations for all types of publicly supported organizations.

Following is a brief review of the tests and procedures developed in the regulations under the 1969 act for classification of organizations generally as public charities by reason of being "publicly supported organizations" described in section 170(b)(1)(A)(vi):

(1) *Mechanical Test.* The regulations under the 1969 act retain the basic ingredients of the mechanical test under the prior regulations, although there are a number of changes and amplifications in the rules. The basic requirement is that at least one third of the support of the organization must be derived from contributions from the general public or support from the government, measured over the preceding four years. An important change made in the new regulations is that in determining contributions from the public, up to 2 percent of total support from any one person may be included, instead of only 1 percent as under the prior regulations. However, for reasons previously indicated, it is likely that many community foundations with substantial endowment income will not regularly receive one third or more of their current support from new gifts and bequests.

(2) *Ten-Percent-of-Support Test.* This is substantially the facts-and-circumstances test, modified so that while it is applicable where the current public support is less than one third, at least 10 percent of total support is required to be derived from the public and/or government. The closer the support from the public or the government is to the 10 percent minimum, the more the organization must establish that under various other facts and circumstances, it has the characteristics of an organization that is normally publicly supported. The ten-percent-of-support test also uses the four-year period for determining whether the organization is normally supported by the public and the government and also uses the 2 percent limit for classifying gifts as derived from the "public." Some community foundations are able to meet a ten-percent-of-support test. Nevertheless, since this rule is generally limited to satisfying the requirement within a four-year period, it is a difficult test to meet since most community foundations have traditionally relied upon support through

bequests which cannot be expected each year. Particularly in smaller communities, qualification under such a support test is unpredictable. Further, the more successful a community foundation is in obtaining endowment funds, the greater will be its investment income and hence the more difficult it will be to meet a test of public support if applied only with reference to a short period (such as four years) as compared with the perspective of a longer period over which the community foundation received such support.

The generally applicable regulations for publicly supported organizations also prescribe special procedures for new organizations (which obviously do not have a prior record of public support) to obtain advance tentative rulings as public charities, based upon representations that the organization will meet either the mechanical test or the ten-percent-of-support test within a five-year period. Also, under the statute, a 501(c)(3) organization may terminate its status as a private foundation and become recognized as a public charity upon satisfying requirements similar to those described above for a new public charity.

A community foundation, which is recognized as a tax-exempt organization under section 501(c)(3), should be classified as a public charity by satisfying the requirements under the Treasury Regulations, as described above, the same as other organizations. In fact, a number of community foundations have been recognized by the IRS as public charities under the 1969 act.

However, special factors enter into the ability of many community foundations to gain recognition as public charities. First, there is the necessity of recognition that a community foundation is an "organization." There has been some confusion on this matter, particularly in the case of community foundations in trust form. Second, there is the problem of the ability of community foundations to meet the public-support test in the comparatively short period prescribed in the generally applicable regulations under the 1969 act. The Treasury Department, taking these factors into account, is considering adopting clarifying rules which prescribe the circumstances under which a community foundation will be treated as one entity and which add structural or operational requirements, as well as special support tests, for classifying a community foundation as a public charity. However, final community foundation regulations have not yet been issued by the Treasury Department. While under existing procedures most donors making current gifts can rely upon the public-charity status of community foundations which have claimed such status (by filing Form 4653 with the IRS), this does not give them any long-range assurance. The community foundations without favorable public-charity rulings are in limbo; they have no assurance or recognition by the I.R.S. of public-charity classification nor a set of rules for achieving that status. The unevenness of the present situation is a deterrent to many community foundations which it is hoped will be corrected in the near future.

Differences Between Community Foundations and Private Grant-Making Foundations

While community foundations may be thought of as having characteristics in some respects similar to those of other large grant-making private foundations, there are important and fundamental differences.

A surface similarity may stem from the fact that a family-created foundation may have developed a governing body consisting of a more representative group than the members of the family who originally created it. However, substantial practical and legal differences exist in the selection of the governing body of a community foundation as compared with that of family foundations. A community foundation must have a governing body representative of the broad interests of the public. The other characteristics of community foundations previously described clearly indicate unique features, both legally and practically.

Attempts to describe community foundations in terms of family grant-making foundations are largely a throw back to the historical beginnings of some community foundations which were designed to find a better way for donors to establish charitable trusts. However, the modern community foundation is no longer regarded as simply a collection of separate charitable trust funds established by various private donors in the community, but rather it is regarded as an entity with a life and purpose of its own and with a mission of building endowment funds to be administered in furtherance of the charitable, educational, and similar public purposes of a particular community. The development of these modern concepts of community foundations has come largely from recognition by community leaders of the force that a community foundation can exert in community development and betterment with broad-based support from the private sector.

This concept of the community foundation fits precisely with the objectives of the Congress in the Tax Reform Act of 1969. That act imposed restrictions on private foundations because that was where Congress found abuses to exist and because Congress believed that only through federally imposed sanctions under the tax law would proper discipline and public benefit be assured. On the other hand, Congress did not find such abuses in "public charities" and ascertained that the accountability of the latter to the public, because of their need to seek and obtain public support, would provide the necessary discipline in lieu of further federal regulations. If this premise of accountability (as related to dependency on public support) is correct, then the same standard can be applied to community foundations as is used for other types of public charities, whether they be educational institutions (which derive support from tuition payments and grants, including those for endowment) or United Fund type organizations (which derive support primarily from annual campaigns plus contributions, in some cases, for endowment purposes). *It is particularly worthy of note that the record of community foundations has been singularly free from abuses of the type brought to the attention of the Congress during the consideration of the 1969 act.*

A question to be considered is whether the concept of responsiveness to the public applies with equal force in the case of a community foundation, which attracts endowment funds, as distinguished from an annual campaign type organization such as a United Fund. However, in both types of organizations support is sought and received from the public and current distributions are made; the difference lies in the fact that in the one case (United Funds) the organization acts as a conduit receiving and distributing principal funds, while in the other case (community foundations) distributions are primarily (but not exclusively) income from an open-ended endowment. The difference between the two methods of distribution may involve a difference in timing of benefits from distributions, but this is not a difference in public *fund raising* as such. In attempting to evaluate responsiveness to the public, it is reasonable to believe that the community-foundation method of administering donated funds and distributing the income therefrom is not less likely to involve continuing and long-term responsiveness to the public than where an organization serves as a conduit. In any event, the evidence of public responsiveness is reflected in continued public support, which it is assumed will be given only if it is deserved. Thus, support of a community foundation by a representative number of persons in the community over a long period of time should be equally as good, if not better, evidence of public responsiveness than short-term support in the case of other organizations.

Moreover, there are various other aspects of accountability present in the case of community foundations, and when these other aspects are taken together, they provide more elements of accountability than may be present in other public institutions. For example, the characteristic fiduciary role of the distribution committee with respect to distributions and the separate fiduciary role of trustee banks with respect to investments, provides a unique dual responsibility which is a long-standing reason for public confidence in community foundations and a basis for their good record of freedom from abuses. As the recitation of other characteristics of community foundations indicates, responsiveness to the community is fundamental to the nature and purpose of a community foundation.

The Importance of Public Charity Classification Under the 1969 Act

While the importance of classification as a "30 percent organization" was recognized prior to 1969 by some community foundations which desired to attract substantial gifts from donors during their lifetimes and which foresaw the possible future importance of such classification amidst rumblings of "tax reform," only about 30 community foundations sought and obtained rulings as publicly supported organizations prior to 1970. However, the Tax Reform Act of 1969 has made it crucial for community foundations to qualify as publicly supported organizations. Classification of community foundations, or funds of community foundations, as "private foundations" would be so inconsistent with the basic concept of the community foundation, as well as the purpose of the 1969 act, that it would be destructive of these foundations' ability to carry out service to the community. A brief examinaton of "private foundation" classification shows the following adverse consequences:

(1) A community foundation would be subject to all of the restrictions on private foundations, including the 4 percent tax on net investment income, so that there would be no advantage to a donor making a gift or bequest to a community foundation as distinguished from creating his own private foundation; and, to that extent, the creation of endowment funds for community needs would be discouraged. Moreover, funds already given to community foundations on the basis of "public charity" treatment would be discriminated against, compared with similar funds given other "public charities." The administrative burdens and loss of integrity of community foundations in the descriminatory treatment of funds could destroy the continued usefulness of these foundations.

(2) Operation of community foundations would be rendered more difficult and expensive by reason of the necessity to seek to comply with private foundation rules which were enacted for other types of organizations (family and company foundations). For example, while the fiduciary standards of community foundations restrict self-dealing in the legal sense, compliance with the arbitrary rules of §4941 (such as tracing the genealogy of all givers to determine "disqualified persons") would be perilous and frustrating because of the substantial number of donors over the years, and hence discouraging to effective management of community foundations for their primary purpose, that is, to fund charitable programs.

(3) Community foundations would not be able to offer the same advantages as other, more narrowly focused institutions in the community that are classified as public charities, such as colleges, universities, hospitals, symphony orchestras, United Fund type organizations, and other publicly supported organizations, which have or are capable of creating endowment funds to receive gifts and bequests of the type traditionally given to community foundations.[9]

(4) Specifically, a community foundation that is a private foundation could not provide for donors desiring to make contributions of appreciated property the same benefits as would be available for them were they to make such contributions to other public charities. Gifts of appreciated property to a public charity may be deducted at full value up to 30 percent of the donor's contribution base (or up to

50 percent of his contribution base, with a reduction of the value of the gift by 50 percent of the appreciation), and, to the extent the deduction cannot be fully utilized in the year of the gift, it may be carried forward for up to 5 years as a deduction. In the case of a gift of appreciated property to a private foundation, the value of the property is generally reduced by 50 percent of the appreciation, the deduction is limited to 20 percent of the donor's contribution base, and there is no carryover of the excess.

(5) A community foundation would, as a private foundation, lose the benefits provided under the 1969 act in the form of incentives to grantor private foundations to make current distributions to public charities or to terminate by transferring their assets to a public charity. Thus in addition to being put at a disadvantage in attempting to receive gifts from individuals, community foundations would lose out as potential distributees from private foundations that may be prepared to turn over their income and possibly their assets to other public institutions.

(6) If a community foundation, or its funds, are treated as private foundations, then separate returns as private foundations must be filed. Not only does this involve additional expense which, together with the 4 percent tax, reduces the income available for charitable purposes, but it also results in greater theoretical exposure to potential liability of trustees and other foundation managers. The latter could have a particularly adverse effect on attracting responsible community leaders to serve as members of the distribution committee or other governing body of a community foundation, especially since members serve without compensation.

(7) Program restrictions imposed on private foundations under the tax law would raise serious questions as to whether a community foundation could carry out one of its fundamental objectives – namely, to take a leadership role in the development of innovative programs for the benefit of the community. The Tax Reform Act of 1969 places emphasis upon private foundations making distributions to public charities and imposes restrictive requirements on grants for new innovative programs that may not be so qualified.

(8) Additional provisions of the tax laws designed to encourage augmenting the funds of public charities would not be available to community foundations. Such provisions include those encouraging charitable remainder trusts and pooled income funds for the benefit of public charities and the establishment of supporting foundations for the benefit of public charities.

(9) Community foundations, if categorized as private foundations, would be considered second-class citizens compared with other service agencies in the community that also must seek public support and would lose the prestige now associated with their standing as institutions for the benefit of the community. This could have important long-range consequences if state and federal legislation, present and future, impose further restrictions and burdens on private foundations not imposed on organizations classified as public charities.

The net effect of these adverse consequences resulting from "private foundation" classification would be that community foundations could no longer fulfill their mission effectively. Other publicly supported organizations might seek to replace them by establishing endowment funds for community benefit, but as pointed out by the former head of United Community Funds and Councils (see p. 1691), such organizations would not actually provide the same unique characteristics and services of a community foundation. A gift or bequest establishing a fund in a limited-purpose organization, such as a college or hospital, obviously does not have the flexibility of a similar gift for community purposes to a community foundation. On the other end of the spectrum, a gift or bequest to establish or add to an endowment fund of an organization whose principal function is to raise funds annually for operating purposes in the communtiy does not give the donor the same sense of security that he obtains upon making a gift or bequest to a community foundation, which is basically an endowment type organization generally making grants only out of income; donors would be concerned that the establishment of a fund in an annual campaign or operating type organization – in which both the current programs and the endowment program come under the same management – can subject funds created for endowment purposes to dissipation because of the need to meet current operating programs.[10]

In short, the failure of a community foundation to be classified as a public charity could relegate it to the same status as that of private foundations which serve certain purposes in the community but which do not develop a broad base of public support needed for a community endowment to meet current and future needs. Philanthropic gifts or bequests which otherwise would be made to a community foundation would likely not be made at all because no other organization serves the same purpose. Thus, private-foundation classification would assuredly slow the growth of community foundations and, ultimately, threaten their continued existence.

IV

EVALUATION OF COMMUNITY FOUNDATIONS: CURRENT ISSUES AND FUTURE ROLE

Current Issues Involving Community Foundations

The prior discussion has pointed up a number of issues involving community foundations. Because of the impact of the tax laws on philanthropy, many of these issues are inexorably tied to the tax law treatment of foundations. Accordingly, any statement of issues involving community foundations must contain elements derived from both the tax laws and public policy.

Despite the risk of being repetitious, it is helpful to state some of the major questions frequently raised about community foundations and which can be taken as a statement of current issues:

1. What is a community foundation: does it have identifiable characteristics to qualify for particular treatment or a role in the spectrum of philanthropy?
2. What interests are to be served by a community foundation, that is, to what extent should a community foundation serve charitable purposes selected by donors or charitable needs of a geographical area otherwise determined?
3. What is the appropriate geographic area to be served, how small or large should it be?
4. What should be the nature of the governance of a community foundation?
5. What concepts of accountability and responsibility should be applicable to community foundations?
6. Where do community foundations stand in an evaluative scale ranking philanthropic organizations by importance, responsibility, and devotion to public interest?
7. Compared with other types of charitable organizations, should community foundations, as charitable endowment funds for a community, be encouraged?

8. Are community foundations subject to particular abuses?

Different responses may be given to these isssues, depending on the approach taken. Like the traditional story of the blind men examining an elephant, a piecemeal examination may result in wholly different conclusions than would a broad view of the entire animal. For example, a person looking only at the grants of a community foundation may regard it simply as another form of grant-making foundation. On the other hand, a broader view of sucessfully operating community foundations will establish that they have uniquely useful characteristics that mark a worthwhile public institution. The good record of community foundations serving the public interest without abuse is not an accident but is attributable to the very design and purpose of the community foundation.

With this perspective, the following comments may be made on each of the above issues.

Community foundations do have identifiable characteristics, as described in Chapter I of this paper. While the form and emphasis will vary, the combination of the factors described in Chapter I makes the community foundation unique. The Treasury Department, in its proposed regulations with respect to community foundations, has apparently had no great difficulty in defining the community foundation in terms of its basic characteristics.

With respect to the interests to be served by a community foundation, the primary purpose of a community foundation quite clearly is, and it should be, to serve the charitable needs of the community or area for which it is designated. Indeed, this is one of the unique characteristics of a community foundation. That a community foundation accepts gifts or bequests for charitable purposes initially designated by donors also contributes to the usefulness of the foundation and should not be viewed as a negative factor. It should be understood, of course, that such designation by donors is permitted only in the initial terms of the gift; subsequent directions by donors are not permitted. Such original designation by a donor does not amount to donor control because the donor does not have continuing control, and, in fact, in a community foundation the governing body has the power to alter such designations. Perhaps more important is the fact that the community foundation, by accepting gifts with an original designation by donors, accomplishes the purpose of keeping the charitable gifts of various donors among the resources of the community and therefore encourages greater philanthropic use of funds that might otherwise be lost as a community resource. While a relatively greater proportion of unrestricted gifts are sought by community foundations, experienced persons in this field recognize that the community is benefitted by inducing more total philanthropic giving through a combination of restricted and unrestricted gifts.

The matter of the appropriate geographic area to be served by a community foundation poses a difficult question. The area should be large enough to attract a broad base of contributions which can be efficiently administered but the area should not be so large that the foundation is removed from the area and people it is to serve. As a practical matter, the problem tends to take care of itself because if the area sought to be served is too large, the community foundation will generally not be supported, and if it is too small there will not be sufficient participation for it to be efficient or effective. There is no indication that any community foundation has been formed to serve other than an area with some geographic homogeneity.

Many different selection procedures have been employed in determining the governance of community foundations, but they all have in common the concept of responsible leadership that will serve the public interest. As previously stated, the concept set forth in the Treasury Regulations – that the governing body should represent the broad interests of the public – clearly conforms to the approach applied by a responsible and responsive community foundation in its governance.

The Treasury Department is also considering limiting the terms of members of the governing body and assuring that neither substantial contributors nor participating banks be over-represented on their boards; but this represents good practice among community foundations anyway. The governing body of the community foundation serves in a unique position: It must be representative of the broad interests of the public and operate so as to attract continuing public confidence and support. However, the governing body must be "independent"; that is, while maintaining fiduciary standards, it is not controlled by donors or any particular constituency and must maintain a broad philanthropic perspective in order to carry out the purposes of the foundation in the community.

With regard to accountability and responsibility to the public, community foundations have had a tradition of operating under fiduciary standards and public reporting. In this respect, community foundations have probably been ahead of most other public institutions, whether universities or United Fund type organizations. To a substantial extent, this tradition stems from these foundations' origin as trust funds for the benefit of the community, and both the distribution committee and the participating banks have traditionally applied fiduciary standards in their respective roles. While, historically, community foundations have made reports to the public, in recent years the nature and extent of these reports has grown, consistent with the widening base of support of community foundations from living donors.

Any attempt to evaluate community foundation relationships to other philanthropic organizations may depend upon the premise from which one starts. Obviously, a community foundation serves a different need than that of a university. On the other hand, a community foundation serves a unique purpose different from an endowment fund for other community agencies and institutions. As indicated in Chapter II in the listing of various projects in which community foundations have provided the leadership, in many communities there would be a void or failure in meeting community needs if were not for such a foundation. The goal should be that every community foundation will play a similar role in the area in which it serves.

The question of whether community foundations should be encouraged may depend upon one's point of view as to the importance or need for community endowment funds. One might argue that endowment funds should be dispersed among various community agencies, such as universities, hospitals, and social agencies; but it should immediately be recognized that such division of endowment funds eliminates the flexibility that exists from having a general endowment fund which can meet varied community needs and is likely to result in a lessening of such funds available to the total community. A community foundation helps keep such funds in the community; without a community foundation, money earned in the community is more likely to be left to national organizations which may be removed from community needs and control.

There is little in past experience to suggest that community foundations have been subject to particular abuses. This is not to deny the need for community foundations, like other institutions, to be constantly alert to the fact that some persons may seek to take advantage of the role and reputation of the foundation to try to dominate or control it or direct its activities into particular channels. Indeed, the structure of community foundations – the nature of their governing bodies and their public accountability – should put them in a position to be more resistant to abuses than some other types of public institutions.

The encouragement given by the Tax Reform Act of 1969 to distributions from private foundations to community foundations and the creation of funds by donors in community foundations present both opportunities and challenges to community foundations to maintain their traditional fiduciary standards and public responsibility. Both the Treasury Department and the Council on Foundations are in a position to convey, and have in fact conveyed, the message that the treatment of community foundations as public charities is based upon a record of freedom from abuses, which must be maintained.

Community foundations are not static instrumentalities. As the prior history has indicated, they have evolved and adjusted their methods of operations to fit the needs in the communities in which they serve. The most successful community foundations are those that have attracted wide support and provided philanthropic leadership in the community in the public interest. Their example should be followed by other community foundations. The Treasury Department also has a role in achieving this objective by providing proper standards in the Regulations; the absence of such Regulations makes this process more difficult.

The only national organization which is in a position to provide private sector leadership among community foundations is the Council on Foundations. Interestingly, the council originated as the "National Council on Community Foundations." It began with meetings of executives of community foundations, who exchanged views on distribution programs, including evaluation of community needs, and how to improve the administration of community foundations. Over the years, the number of community foundations that recognized the advantages of such meetings grew. The council's conventions attracted other philanthropic organizations similarly interested in the effective use of charitable funds, and this led to the association with the council of other charitable organizations that were not community foundations.

The Council on Foundations has now grown to a much larger organization but it maintains a strong body of community foundation membership (115 community foundations are members). The council has a separate Community Foundations Committee which provides information and guidance, through communications and educational programs, for the benefit of community foundations generally.

The Council on Foundations has an ongoing program to help citizen groups form community foundations and to enroll community foundations that are not members. Council staff also assist existing community foundations, particularly the newly developed ones. The council plays an important role in helping to establish standards, providing forums for interchange of ideas with regard to community service, and providing suggestions based on the experience of others, so as to improve the management and public service of community foundations.

Thus, the mechanisms are present for maintaining high standards in community foundation operations, through leadership in the private sector, in the form of an organization like the Council on Foundations, and through governmental pressures, in the form of Treasury regulations. The fact is that community foundations have demonstrated that they can and do play a valuable and necessary role in public service in the community. The resolution of current issues involving community foundations, should, therefore, not turn on the viability of the concept and structure – the values of which have been established – but rather on whether proper standards are maintained, assuring responsiveness to the public interest. This is the same challenge faced by all public philanthropic institutions, and community foundations should be encouraged along with the other public charities that are able to meet this challenge.

The Future Role of Community Foundations in Private Philanthropy

The Tax Reform Act of 1969 has had an important effect upon the directions of philanthropic support. Clearly, the act was intended to and has accomplished the purpose of channeling greater philanthropic support to public charities as distinguished from private foundations. It is well known that the birth rate of private foundations has subsided. Nevertheless, the need for support from the private sector has not abated, and it is in this connection that community foundations can play an increasingly important role. The elements of that future role would appear to be the following.

The Community Foundation as a Prime Object of Philanthropic Giving

The community foundation has certain unique characteristics which make it particularly attractive and important as a community resource to which philanthropic funds should be given. Its purposes are as broad as the community needs. When this is coupled with the fact that the community foundation is operated under fiduciary standards and governed by a representative governing body, it offers the greatest opportunity for meaningful charitable gifts from those whose interest and concern is the welfare of the community. The community foundation should appeal to those who want to be effective and supportive but do not want their gifts channeled narrowly or to become outmoded. It is the vehicle best suited to serve such a purpose.

Development of Associations of Foundations

In some cities, community foundations have taken the lead in encouraging associations of foundations for evaluation of community needs and making common grants based upon such evaluation. The staff of the community foundation can provide analyses and recommendations that would probably not otherwise be available to many family foundations. This does not destroy the vitality and independence of private foundations, but it adds direction and leadership which a community foundation can supply in meeting community needs.

The net effect of this kind of program should be improvement in philanthropic efforts in the community and a greater leadership role on the part of the community foundation. While this should contribute to the more effective use of funds of private foundations, it will also demonstrate the role that community foundations can play, and, in that sense, it should augment the use, as well as the funds, of community foundations for community betterment.

Conversion of Private Foundations into Supporting Foundations of Community Foundations

The Tax Reform Act of 1969 gave recognition to a particular type of privately endowed charitable fund which could be classified as a "public charity" by reason of being a "supporting organization" appropriately affiliated with a public charity. (IRC §509(a)(3).) Public-charity status is based upon compliance with rules requiring that the supporting organization be operated for the benefit, or in furtherance of the purposes, of one or more specified public charities and be operated under their supervision or control or in connection with them and not be controlled by the supporting organization's substantial contributors or members of their families.

One of the possibilities for the future is that in the case of some family-created foundations, the family will turn over control of its foundation to the community foundation to operate thereafter under the rules of section 509(a)(3) as a supporting organization for the community foundation. This may be done, not as a tax gimmick, but for the purpose of augmenting the community foundation while at the same time maintaining a separate identification for the family-created foundation in the interest of inducing further support. Community foundations that accept such funds must exercise the same care as schools, hospitals, and other institutions that accept them. The Treasury Regulations precisely define what attributes of supporting organizations must be present and provide safeguards against misuse. It is not out of order for community Foundations to encourage such affiliations, as long as the community foundations are willing to take on the responsibility of properly supervising the supporting organizations.

Termination of Private Foundations into Community Foundations

The Tax Reform Act of 1969 specifically encourages the termination of private foundations into public charities. While this may be regretted in some quarters, because it eliminates some of the pluralism of decision making that private foundations provide in our society, it should not be regretted if it has the effect of making more effective use of charitable funds by aggregating them under a common responsible management in a community foundation. For example, the absorption of a number of small unstaffed private foundations by a staffed community foundation might be beneficial because it achieves economy of operations and brings a staff capability to the use of charitable funds. The Treasury Regulations recognize that private foundations may be so terminated into designated funds of community foundations (as well as those of other public charities). The data reported in Chapter I indicate that in fact there has been a substantial shift of funds from private foundations into community foundations. To the extent that this represents the shift to community foundations of private foundations too small to be economically administered, this should contribute to more effective use of charitable funds for public purposes.

V

SUMMARY AND RECOMMENDATIONS

The possibility of community foundations growing substantially through the acquisition of assets of private foundations emphasizes the greater role and responsibility of community foundations in the future. The thrust of the 1969 act in restricting private foundations and in encouraging public charities puts great emphasis upon the role that a community foundation can play as the one overall organization for a community, designed to harness the resources of private philanthropy for public needs. Community foundations must approach this new role studiously, energetically, and responsibly.

Both the structure and past record of community foundations justify confidence that these organizations can serve a sound purpose in providing major philanthropic support in the community and a leadership role in community projects in the future. These foundations must, however, be prepared to justify their continued privileges and should constantly evaluate, and be prepared to strengthen, their operations. The following are developments or recommendations that look to the strengthening of community foundation operations:

1. Community foundations should be adequately staffed. The positive role that many community foundations play is due not only to participation by community leaders but also to the presence of professional staff who can make the analyses, plan the projects, and provide expert guidance for the philanthropic sector of the community.

2. Community foundations in smaller communities should reexamine their role and responsibility where the community size is not sufficient to support the growth of the community foundations, or expanding to serve a larger population on a regional basis, so as to obtain sufficient public support to both provide staff and take a positive role in meeting charitable needs in the community.

3. It is important that new community foundations obtain some gifts at the outset to carry them through the lean start-up period. Such funds will speed the day when they can have staff and a program calculated to attract maximum community support.

4. Community foundations should strive for greater understanding by the community of their role. This is not merely for the purpose of improving their image, but rather it is to fulfill the need for broad-based participation and provide leadership in support of private philanthropy. More community foundations should take an active role in the community to focus on community needs and help to bring together community resources to meet such needs. This leadership role is illustrated by examples previously given in Chapter II.

5. In connection with the last point, more community foundations can follow the example of those that are providing service to community agencies and other foundations for the more effective use of community resources. Such services include evaluating grant requests, coordinating proposals, holding meetings on community needs, and in other ways seeking to improve the use of funds available from private and governmental sources for the benefit of the community.

6. Community foundations should continue to broaden their base of support in the communities they serve. They should do more to encourage medium-sized gifts as well as large ones. The creation of Community Funds Inc., as an affiliate of New York Community Trust, is an example of one method of accomplishing this. They should encourage more lifetime gifts to obtain current interest and support, rather than be dependent upon bequests. There are many ways of encouraging people to build up funds during life, including the use of charitable remainder trusts. In short, a goal should be to encourage more people to have a stake in their community's future through the community foundation.

7. Community foundations should encourage greater participation by the involvement of more citizens. The use of advisory committees for various projects or to advise the distribution committee as to grants are some of the ways to expand involvement. Another means is to create special-purpose funds for subjects of community interest, such as library funds, arts funds, scholarship funds. The New Hampshire Charitable Fund is providing an example of this type of involvement on a statewide basis.

The above suggestions reflect practices already undertaken in many communities. They represent means whereby community foundations can and do serve to demonstrate the value of private philanthropy in a community. Community foundations should be encouraged to be a model for involvement of the private sector in the community as an alternate and supplement to governmental programs.

Appendix A

GEOGRAPHICAL LISTING OF COMMUNITY FOUNDATIONS

ALABAMA

The Greater Birmingham Foundation, Birmingham

ARIZONA

The Phoenix Welfare Foundation, Phoenix

CALIFORNIA

The Alameda-Contra Costa Counties Community Foundation, Oakland
California Community Foundation, Los Angeles
The Corcoran Community Foundation, Corcoran
Fresno Regional Foundation, Fresno
Glendale Community Foundation, Glendale
The Humboldt Area Foundation, Eureka
Monterey Foundation, Monterey
Newport Harbor Foundation, Newport Beach
Novato Civic Foundation, Novato
Pasadena Foundation, Pasadena
Riverside Foundation, Riverside
The San Francisco Foundation, San Francisco
The San Mateo Foundation, Burlingame
Santa Barbara Foundation, Santa Barbara
Community Trust of Santa Clara County, Santa Clara
Santa Cruz-El Pajaro Foundation, Waterville
Santa Rosa Foundation, Santa Rosa

COLORADO

Colorado Springs Community Trust Fund, Colorado Springs
The Denver Foundation, Denver
The Greater Englewood Foundation, Inc., Englewood
Mesa County Foundation, Inc., Grand Junction

CONNECTICUT

The Bridgeport Area Foundation, Inc., Bridgeport
Greenwich Foundation for Community Gifts, Greenwich
The Hartford Foundation for Public Giving, West Hartford
The Meriden Foundation, Meriden
New Britain Foundation for Public Giving, New Britain
The New Haven Foundation, New Haven
The Greater Norwalk Community Foundation, Inc., Norwalk
Stamford Foundation, Stamford
The Torrington Community Foundation, Torrington
Waterbury Foundation, Waterbury

DELAWARE

The Delaware Foundation, Wilmington

DISTRICT OF COLUMBIA

The Community Foundation of Greater Washington, Inc.

FLORIDA

The Broward County Foundation, Inc., Fort Lauderdale
Dade Foundation, Miami
Palm Beach County Community Foundation, West Palm Beach
The Greater Jacksonville Area Community Foundation, Jacksonville
The Community Foundation of Sarasota, Sarasota
Pinellas County Community Foundation, Clearwater
Winter Park Community Trust Fund, Winter Park

GEORGIA

Metropolitan Foundation of Atlanta, Atlanta
The Atlanta Foundation, Atlanta
Metropolitan Augusta Foundation, Augusta
Savannah Foundation, Inc., Savannah

HAWAII

The Hawaiian Foundation, Honolulu
Hana Maui Trust, Hana

ILLINOIS

The Alton Foundation, Alton
The Aurora Foundation, Aurora
The Centralia Foundation, Centralia
The Chicago Community Trust, Chicago
Community Foundation of Champaign County, Inc., Champaign
The Moline Foundation, Moline
Oak Park-River Forest Community Foundation, Oak Park
The Quincy Foundation, Quincy
The Rock Island Community Foundation, Rock Island
Rockford Community Trust, Rockford
Sterling-Rock Falls Community Trust, Sterling

INDIANA

The Brookville Foundation, Brookville
Fort Wayne Foundation, Inc., Fort Wayne
The Greencastle Foundation, Greencastle
The Indianapolis Foundation, Indianapolis
Kosciusko County Foundation, Warsaw
The North Manchester Community Foundation, Inc., North Manchester
The Portland Foundation, Portland
Community Foundation of St. Joseph County, Inc., South Bend
Sullivan County Foundation, Sullivan
The Wells County Foundation, Inc., Bluffton
The Winchester Foundation, Winchester

IOWA

Cedar Rapids Community Welfare Foundation, Cedar Rapids
Davenport Area Foundation, Davenport
The Waterloo Civic Foundation, Waterloo
Waverly Community Foundation, Waverly

KANSAS

The McPherson Community Foundation, McPherson
Salina-Charities Foundation, Inc., Salina

KENTUCKY

Blue Grass Foundation, Inc., Lexington
Lexington-Fayette County Foundation, Inc., Lexington
Greater Ashland Foundation, Ashland
The Owensboro-Daviess County Community Foundation, Owensboro

LOUISIANA

Baton Rouge Area Foundation, Baton Rouge
Shreveport-Bossier Foundation, Shreveport

MAINE

Maine Charity Foundation, Portland
The North Haven Foundation, North Haven

MARYLAND

The Community Foundation of the Greater Baltimore Area, Inc., Baltimore

MASSACHUSETTS

Attleboro Foundation, Attleboro
Brockton Charitable Fund, Inc., Brockton
Committee of the Permanent Charity Fund, Inc., Boston
The Cornerstone Charitable Foundation, Boston
The Cambridge Foundation, Cambridge
Dover Foundation, Inc., Dover
Greater Fall River Foundation, Inc., Fall River
Old Colony Charitable Foundation, Boston
Perpetual Benevolent Fund, Waltham

MICHIGAN

The Ann Arbor Area Foundation, Ann Arbor
Greater Battle Creek Foundation, Battle Creek
Berrien Community Foundation, Benton Harbor
The Colon Foundation, Colon
Detroit Community Trust, Detroit
The Flint Public Trust, Flint
The Fremont Area Foundation, Fremont
Grand Blanc Community Foundation, Flint
Grand Haven Area Community Foundation, Inc., Grand Haven
Grand Rapids Foundation, Grand Rapids
The Greater Holland Community Foundation, Inc., Holland
The Jackson Foundation, Jackson
Kalamazoo Foundation, Kalamazoo
The Greater Lansing Foundation, Lansing
Leelanau Township Foundation, Inc., Northport
Midland Community Foundation, Midland
Muskegon County Community Foundation, Muskegon
Oakland County Community Trust, Detroit
Port Huron District Foundation, Inc., Port Huron
The Pontiac Foundation, Pontiac
Thornapple Foundation, Hastings
Vicksburg Foundation, Vicksburg

MINNESOTA

Duluth Community Trust, Duluth
The Minneapolis Foundation, Minneapolis
The Rochester Foundation, Rochester
Saint Paul Foundation, St. Paul

MISSOURI

Kansas City Association of Trusts & Foundations, Kansas City
St. Louis Community Trusts, St. Louis
Peculiar Charitable Foundation, Peculiar

NEBRASKA

The Lincoln Foundation, Inc., Lincoln
Merrick Foundation, Central City

NEW HAMPSHIRE

Dublin Community Foundation, Dublin
New Hampshire Charitable Fund, Concord
The Randolph Foundation, Randolph

NEW JERSEY

The Plainfield Foundation, Plainfield
Trenton Community Foundation, Trenton
South Jersey Foundation, Moorestown

NEW YORK

The Buffalo Foundation, Buffalo
Community Foundation of Central New York, Syracuse
Greater Endicott Area Foundation, Endicott
Glens Falls Foundation, Glens Falls
Lyndonville Area Foundation, Inc., Lyndonville
Mohawk-Hudson Community Foundation, Inc., Albany
New York Community Trusts & Community Funds, Inc., New York
Poughkeepsie Area Fund, Inc., Poughkeepsie
Greater Rochester Community Foundation of the Genesee Valley, Rochester
Scarsdale Foundation, Scarsdale
The Schenectady Foundation, Schenectady
The Tompkins County Foundation, Inc., Ithaca
The Community Foundation of Unadilla, New York, Inc., Unadilla
Utica Foundation, Inc., Utica
The Watertown Foundation, Inc., Watertown

NORTH CAROLINA

Greater Charlotte Foundation, Inc., Charlotte
Durham Foundation, Inc., Durham
Elizabeth City Foundation, Elizabeth City
Granite Falls Community Foundation, Granite Falls
Hickory Community Foundation, Inc., Hickory
Landis Community Foundation, Inc., Landis
Rocky Mount Foundation, Rocky Mount
Salisbury Community Foundation, Inc., Salisbury
Thomasville Community Foundation, Inc., Thomasville
The Winston-Salem Foundation, Winston-Salem

NORTH DAKOTA

Fargo-Moorhead Area Foundation, Fargo

OHIO

Akron Community Trusts, Akron
Ashtabula Foundation, Inc., Ashtabula
Bryan Area Foundation, Bryan
Canton Welfare Federation Community Memorial Trust, Canton

The Greater Cincinnati Foundation, Cincinnati
The Cleveland Foundation, Cleveland
The Columbus Foundation, Columbus
The Dayton Foundation, Dayton
The Fayette County Charitable Foundation, Washington Court House (Fayette)
Galion Community Foundation, Galion
Hamilton Community Foundation, Inc., Hamilton
Lake County Foundation, Painesville
Licking County Foundation for Public Giving, Newark
The Lorain Foundation, Lorain
The Marietta Community Foundation, Marietta
Mercer County Civic Foundation, Celina
The Mount Vernon Community Trust, Mount Vernon
Richland County Foundation of Mansfield, Ohio, Mansfield
Salem Community Foundation, Inc., Salem
The Sidney Community Foundation, Sidney
The Springfield Foundation, Springfield
The Stark County Foundation, Canton
The Tipp City Foundation, Troy
The Toledo Community Foundation, Toledo
The Troy Foundation, Troy
Van Wert County Foundation, Van Wert
Youngstown Foundation, Youngstown
St. Clair Foundation, Lewisburg

OKLAHOMA

Muskogee County Community Action Foundation, Inc., Muskogee
Tulsa Permanent Community Trust Disbursing Committee Funds, Tulsa
Oklahoma City Community Foundation, Inc., Oklahoma

OREGON

The Benton County Foundation, Corvallis
Oregon Community Foundation, Portland
The Pendleton Foundation Trust, Pendleton
Salem Foundation, Salem

PENNSYLVANIA

The Altoona Foundation, Altoona
Ashland Trusts, Ashland
Bethlehem Area Foundation, Bethlehem
Emporium Foundation, Inc., Emporium
The Erie Community Foundation, Erie
The Greensburg Foundation, Greensburg
The Grove City Foundation, Grove City
The Harrisburg Foundation, Harrisburg
The Lancaster County Foundation, Lancaster
Central Montgomery County Foundation, King of Prussia
The Philadelphia Foundation, Philadelphia
The Pittsburgh Foundation, Pittsburgh
The Scranton Area Foundation, Scranton
The Warren Foundation, Warren
Williamsport Foundation or Community Trust, Williamsport
York Foundation, York

RHODE ISLAND

The Rhode Island Foundation, Providence

SOUTH CAROLINA

Anderson Community Foundation, Inc., Anderson
The Greenville County Foundation, Greenville
Hilton Head Island Charitable Foundation, Hilton Head Island
The Spartanburg County Foundation, Spartanburg

TENNESSEE

Community Foundation of Greater Chattanooga, Inc., Chattanooga
Community Improvement Foundation of East Tennessee, Knoxville
The Memphis-Plough Community Foundation, Memphis

TEXAS

Amarillo Area Foundation, Inc., Amarillo
Bellville Community Foundation, Bellville
Central West Texas Charitable Foundation, Abilene
Dallas Community Chest Trust Fund, Dallas
Dallas Foundation, Dallas
Gray-Pampa Foundation, Inc., Pampa
Navarro Community Foundation, Corsicana
San Antonio Area Foundation, San Antonio
Waco Perpetual Growth Foundation, Waco
Waxahachie Foundation, Inc., Waxahachie

VERMONT

Northwestern Vermont Community Foundation, St. Albans
Vermont Charitable Foundation, Waitsfield

VIRGINIA

Norfolk Foundation, Norfolk
Portsmouth Community Trust, Portsmouth
The Richmond Foundation, Richmond
The Greater Richmond Community Foundation, Richmond

WASHINGTON

Foundation for Enumclaw Community, Inc., Enumclaw
The Seattle Foundation, Seattle
Spokane Foundation, Spokane
Stanwood-Camano Area Foundation, Stanwood

WEST VIRGINIA

The Greater Kanawha Valley Foundation, Charleston
Parkersburg Community Foundation, Parkersburg

WISCONSIN

The Ashland Foundation, Ashland
Beloit Foundation, Inc., Beloit
Cambridge Foundation, Cambridge
Fort Atkinson Community Foundation, Fort Atkinson
Kenosha Foundation, Kenosha
La Crosse Foundation, La Crosse
Madison Community Trust Fund, Madison
The Milwaukee Foundation, Milwaukee
Oshkosh Foundation, Oshkosh

WYOMING

Cheyenne Community Trust, Cheyenne

Appendix B

FINANCIAL AND OTHER DATA ON COMMUNITY FOUNDATIONS

Table B-1

Assets of Community Foundations By Size Category
(Based on the 1970 status report figures)

Size (in thousands)	Community Foundations		Total Assets	
	Number	Percent		
$0-500	148	62.19%	$ 14,483,879	1.82%
500-1,000	28	11.76	20,399,586	2.57
1,000-5,000	38	15.97	82,727,074	10.42
5,000-10,000	8	3.36	60,660,305	7.64
10,000-50,000	12	5.04	256,891,959	32.35
50,000 and over	4	1.68	358,975,508	45.20
Totals	238	100.00	$794,138,311	100.00

Source: Council on Foundations

Table B-2

List of Community Foundations With Assets Over $10 Million

Name of Community Foundation	Fiscal/Calendar Year	Market Value of Assets	Total Grants
The New York Community Trust	12/31/73	$193,190,648	$ 9,826,996
The Cleveland Foundation	12/31/73	168,614,000	5,741,989
The Chicago Community Trust	10/31/73	90,014,038	3,747,175
Committee of the Permanent Charity Fund, Inc. (Boston)	6/30/73	79,360,230	3,387,239
The San Francisco Foundation	6/30/73	48,716,843	4,203,911
Vancouver Foundation	12/31/73	47,163,102	2,685,294
Hartford Foundation for Public Giving	9/30/73	44,679,684	1,374,655
The New Haven Foundation	12/31/73	32,649,689	1,198,522
The Philadelphia Foundation	4/30/74	30,216,807	1,618,460
The Winston-Salem Foundation	12/31/73	28,986,330	932,987
Kalamazoo Foundation	12/31/73	25,953,321	1,175,461
The Pittsburgh Foundation	12/31/73	25,286,186	1,150,977
California Community Foundation	8/31/73	21,564,372	1,842,173
Dallas Community Chest Trust Fund	10/31/73	19,000,000	1,163,414
The Indianapolis Foundation	12/31/73	18,219,919	701,759
The Columbus Foundation	12/31/73	17,489,747	1,104,589
Kansas City Association of Trusts & Foundations	12/31/73	17,000,000	657,915
The Rhode Island Foundation	12/31/73	16,704,259	685,459
Grand Rapids Foundation	6/30/73	13,434,986	786,236
Winnipeg Foundation	10/3/73	12,896,087	575,631
Saint Paul Foundation	12/31/73	10,988,629	343,841
The Minneapolis Foundation	3/31/74	10,305,695	913,084
Totals		$972,434,572	$45,817,767

Source: Council on Foundations

Table B-3

Number and Distribution of Community Foundations By Region
(Based on the 1970 status report figures)

Region	Number of Community Foundations		Total Distributions	
New England	25	10.82%	$ 6,486,975	15.54%
Middle Atlantic	31	13.42	7,957,189	19.06
East North Central	76	32.90	14,711,412	35.24
West North Central	15	6.49	1,595,648	3.82
South Atlantic	31	13.42	4,017,021	9.63
East South Central	6	2.60	225,246	.54
West South Central	15	6.49	653,465	1.57
Mountain	6	2.60	43,117	.10
Pacific	26	11.26	6,051,048	14.50
Totals	231	100.00	$41,741,121	100.00

Source: Council on Foundations

Table B-4

Field Preference for Community Foundations Compared With
Grant Distributions of All Foundations, 1972-1973

	Community Foundation Grants		Total Foundation Grants	
Field	Amounts (in millions)	Percent	Amounts (in millions)	Percent
Welfare	$18.56	35.58%	$200	13.50%
Health	12.72	24.34	295	20.00
Humanities	5.65	10.82	122	8.00
Religion	1.78	3.41	26	2.00
Sciences	2.64	5.05	217	14.50
International Activities	0.17	0.32	161	10.50
Education	10.69	20.46	464	32.50

Source: Council on Foundations. Figures are from the Foundation Center Data Bank, based on reports to the Foundation Center in 1972 and 1973. The data do not include all community foundation grants but are based upon approximately $50 million in grants.

Footnotes

1. The terms "community trust" and "community foundation" are hereafter used interchangeably, with no distinction intended unless specified. The term "community trust" originally reflected not only the concept of funds held in trust for the benefit of the community, but also that the trust form was used with a bank as trustee. The term "community foundation" became more commonly used to describe the concept, whether given effect in the form of bank trusteeship or corporation. Thus today some "community foundations" are established under a declaration of trust and some "community trusts" are independent nonprofit corporations. The Treasury Department has used the term "community trust" in its regulations, but the more frequently used term, and that used herein to describe all such organizations, is "community foundation."

2. American Association of Fund-Raising Counsel, Inc., *Giving U.S.A.*, 1973, pp. 15-16 and 1974, pp. 16-17.

3. Council on Foundations, "Private Foundations and the 1969 Tax Reform Act," paper prepared for the Commission on Private Philanthropy and Public Needs, 1975, pp. 1560-61.

4. The nation's second largest community foundation has already announced a substantial increase in its grants. Quoted in *The New York Times*, January 15, 1975, as saying this "is the time to spend," Homer C. Wadsworth, president of The Cleveland Foundation, reported that the foundation's spending would be increased 25 to 30 percent in 1975, notwithstanding an estimated 24 percent decline in asset values.

5. The "facts and circumstances test" prescribed by Treasury Regulations under §170(b)(1)(A)(vi) both prior to the 1969 Act and since contain a requirement for a "representative governing body" which is generally descriptive of the concept employed in community foundations. The present statement of this concept in Reg. §1.170A-9(e)(3)(v) is as follows: "(v) *Representative governing body*. The fact that an organization has a governing body which represents the broad interests of the public, rather than the personal or private interests of a limited number of donors (or persons standing in a relationship to such donors which is described in section 4945(a)(1)(C) through (G)), will be taken into account in determining whether an organization is 'publicly supported.' An organization will be treated as meeting this requirement if it has a governing body (whether designated in the organization's governing instrument or bylaws as a Board of Directors, Board of Trustees, etc.) which is comprised of public officials acting in their capacities as such; of individuals selected by public officials acting in their capacities as such; of persons having special knowledge or expertise in the particular field or discipline in which the organization is operating; of community leaders, such as elected or appointed officials, clergymen, educators, civic leaders, or other such persons representing a broad cross-section of the views and interests of the community; or, in the case of a membership organization, of individuals elected pursuant to the organization's governing instrument or by-laws by a broadly based membership."

6. See William T. Swartz, "How New Haven Created a New Corrections Center," *Foundation News* (May/June 1974), p. 21.

7. See Pat Geisler, "Getting It All Together," *Foundation News* (March/April 1973), p. 27.

8. See Gary M. Hook, "Organizing A Fight Against Drug Abuse," *Foundation News* (November/December 1972), p. 23.

9. It is interesting to note that in some communities other operating and fund-raising institutions have been instrumental in the formation of a community foundation because they recognize that a community foundation may be more likely to attract endowment funds for the benefit of the community and its institutions than they are.

10. See prior discussion, p. 1704 and note 9, supra.

THE CHARITABLE FOUNDATION: ITS GOVERNANCE

Lawrence M. Stone[†]

Introduction

Private foundations have several characteristics that distinguish them from other charitable institutions: (1) they are generally dependent on a single donor (or family) for their funds and derive none of their financial support from broad-based public fund raising; (2) they have a unique independence since they often retain contributions received as a capital fund and spend only the income which the capital fund earns; and (3) rather than operating charitable aid programs or research activities themselves, they usually make grants to other charities, institutions, or individuals to carry on such work. Thus, they are a relatively permanent, nongovernmental source of floating capital endowment for alternative public purpose activities. This uniquely uncommitted endowment gives the private foundation its singular freedom to act, a freedom that is at once its greatest virtue and its most vulnerable point.

The private foundations' independence, flexibility, and ability to respond to changing times and new problems[1] make these organizations perhaps the most valuable and most essential segment of the entire private nonprofit sector. No other private charitable institution or organizational structure seems so perfectly designed to respond to the changing needs of a democratic, pluralistic society.

Despite the apparent advantages of the private foundation, it has been the object of more criticism than any other single area of private philanthropy. As a result it has increasingly been placed in a less favorable position than other so-called publicly supported charities with regard to federal tax benefits.

There are several explanations of what has led to the private foundation's susceptibility to criticism:

1. Contributions to private foundations come from wealthy families. Any controversy or criticism regarding such large concentrations of wealth in our society is easily transferable to the private foundations which have been created with this wealth. Indeed, such criticism of the private foundation may actually be an expression of dislike for the institution of private property.[2]

2. Large tax benefits are usually associated with both the creation and operation of foundations. These benefits lower the cost of charitable giving. However, as the burden of taxation becomes heavier, especially for the middle-income taxpayer, scapegoats are sought. The private foundation, having only a small, albeit wealthy, voting constituency is especially vulnerable to criticism in this regard because of its image as a tax haven for the wealthy.

3. Some private foundations have been set up and operated for the private purposes of their donors; some pursue goals that have little if any relation to the public interest; still others have accumulated income while spending little on current charitable or public needs. These clear abuses of the tax benefits already received and of the public-trust status of contributed funds have brought criticism to bear on all foundations, and indeed on all philanthropy. Increased enforcement efforts and changes in the law, especially the Tax Reform Act of 1969, have done much to

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reduce the possibility of such abuses. But some needed steps—such as ensuring gradual relinguishment of donor control—have yet to be taken. Furthermore, what some view as overly generous "grandfather" clauses—such as requirements in the 1969 act for divestment of business control[3]—have weakened the reform. In any event, the public image of the private foundation has been slow to change.

4. For foundations to fulfill their promised role, they must exploit their unique independence by engaging in new, innovative, and often controversial activities. Because of this, foundations have from time to time been heavily cirticized from all sides—by Republicans and Democrats, tax conservatives and tax liberals, populists and propertied interests. Such criticism is usually a sign of the vigor of the institution and will, we would hope, not be silenced.

5. Many foundations—including those that may have performed their fiduciary obligations flawlessly, without self-dealing or private benefits—have nevertheless remained truly "private." Generally speaking, this means that they are controlled by a small, self-perpetuating group consisting either of the donor and the donor's family or of others who have gained control through their relationships to the original control group. Furthermore, foundations—even those not so closely controlled—have with few exceptions drawn their directors and chief personnel from a narrow and relatively homogeneous base. Many foundations also have been reluctant to disclose adequate information about their finances and activities, doing so only under the heaviest of criticism or because of government regulation.

Since private foundations are dependent on neither public fund raising nor public membership, it is not surprising that they have tended to exhibit characteristics of "privateness." Yet such uncontrolled, narrow-based power, especially when it enjoys the benefit of tax support, cannot be expected to be popular in our society. The few private foundations that have managed successfully to emerge from this stereotype and have progressed beyond this state of privateness might be well advised to refer to themselves as "charitable foundations" or "public foundations"—even though the effect is concededly cosmetic.[4]

The purpose of this paper is to examine current problems in the governance of private foundations, some of which have been summarized above, and to suggest possible solutions to help quiet the private foundations' critics without undermining the foundation's essential role. While directed at private foundations, much of what is discussed is also applicable to other charitable institutions that are similarly characterized by privateness or "non-publicness" and that also may share some of the alleged weaknesses of the foundations' governance structure.

I

LONG-RANGE STRATEGY

The grant-making private foundations will not continue to play an important role in American society unless it is determined that they are worth the price society must pay to sustain them. The "price" has two aspects—one, monetary (tax incentives) and the other, independence which in effect gives to private persons the right to appropriate monies that would otherwise be collected as taxes and appropriated by the legislature.[5] Foundations, notwithstanding the considerable progress of recent years, continue to be in a precarious position. Therefore, a long-range strategy must be developed to improve the image of the private foundation.

There clearly are limits to what can be done to lessen the political vulnerability of the private foundation. Once its public image has been tarnished it is very difficult for an institution or group to rid itself of such a stigma. This is an era in which it is fashionable to challenge existing institutions as being "irrelevant" or in need of "radical" change. There would appear, however, to be an appropriate strategy for the private foundation. Such a strategy should be based first and foremost on fulfilling the theoretical promise of the foundation to be the "cutting edge" of philanthropy, the sympathetic ear to the "voices in the wilderness," and the patron of pathfinders.

However, as a precondition to their ability to act with such independence, foundations must avoid making themselves easy targets for political criticism. Abuses, and the potential for abuse, must be dealt with forthrightly and promptly. Foundations as a group should themselves be responsible for playing a "watchdog role." Since there is always the possibility that criticism of some charitable organizations will spill over to all charitable institutions, the willingness of foundations to take the lead in encouraging sound government regulation of all charity, subject to the proviso that such regulation not interfere with their own vital independence or that of other charitable institutions, is equally important to this long-range strategy. Foundations should be in the forefront of delineating for the public and for Congress those areas of all charitable activity that should be open to reasonable government regulation.[6] The limitations on self-dealing and control-of-business provisions recommended in 1965 by the Treasury Department and enacted in 1969 should, under this strategy, have received strong and unqualified support by the foundation community. Similarly, foundations should be receptive to reasonable demands for disclosure and public accountability.[7]

However, it is not necessary—*or advisable*—that foundations and their supporters accept as permanent any unnecessary concessions to government regulation—such as the present tax benefit discriminations against gifts to foundations in favor of gifts to "public charities."[8] Furthermore, an approach aimed at preventing all possible abuses is unwise if it risks the serious curtailment of the foundation's independence and flexibility: to do so could ultimately lead to the destruction of the institution we seek to preserve.[9] Some criticisms—for example those relating to financial self-dealing—should, and can be, and to a large extent have been met by direct and rigorous government regulation. Unfounded criticism—such as charges that foundations control the economy or are responsible for high income taxes—should be repudiated vociferously, just as are such irresponsible attacks on free speech, academic freedom, and an independent judiciary, three other important bulwarks of a free society. To deal with problems that fall somewhere in between, solutions are discussed below that would combine private regulation with semigovernmental controls or legitimacy-creating devices.

If foundations have kept their own "skirts clean," they will then be in a position to carry out the more important part of a long-range strategy of securing their recognition as vital to American society. This simply calls for the fulfillment of their promise. Foundations should be far more active in supporting through their grant-making process those ombudsman activities now permitted by law.[10] In this era when voters are called upon to decide on complex matters such as what degree of safety is required for nuclear power plants, how much military power does the United States require to defend itself, and what is appropriate economic policy to maintain full employment and avoid inflation, free press, town hall meetings, and academic freedom do not suffice to allow informed, democratic decisions. What are needed are extensive privately supported research activities that will provide the necessary information on complex issues for the press and others to disseminate. Similarly, in these days of almost overwhelming power of government, the protection of individual rights requires in many cases sustained and complex litigation that can be carried on only by public interest groups.

Moreover, foundations and their supporters must convince Congress that privately supported, nonprofit organizations are needed to counteract corporate and other private interest lobbies in federal, state, and local legislatures. These activities are now largely foreclosed to charitable organizations,[11] while business interests are afforded wide latitude to conduct non-grassroots lobbying with tax deductible dollars in matters connected with their business interests. If private foundations were permitted to make grants in support of lobbying activities, they would provide the requisite and vital counterforce to large government and its consequent private business lobbies.[12]

II

SOME SPECIFIC RECOMMENDATIONS

Areas of Appropriate Government Regulation

To maintain public confidence in the integrity of the management of private foundations, government regulation should be exercised in a reasonable manner to achieve

(a) prevention of self-dealing or other forms of private benefit;

(b) prevention of "privateness" through full disclosure of foundation operations;

(c) soundness of foundation investments;

(d) a balance between accumulation of capital and spending for present needs;

(e) proper application of foundation funds, for example, avoidance of improprieties, such as giving for political purposes; and

(f) to a limited extent, the prevention of "privateness" in the form of indefinite control by donors or donees over any particular foundations.

Areas in Which to Avoid Government Regulation

To preserve foundation independence and to allow foundations to carry out their missions, there should be no government regulation of the grant-making process. This includes both the foundation's selection of areas of interest and the actual making of grants to donees.

Areas of Experimentation With Different Regulatory Approaches

To encourage the continued growth of the private foundation while attempting to satisfy the justifiable demands for regulation, there should be experimentation with private regulation. The Financial Accounting Standards Board,[13] established by independent public accountants, and private regulatory boards with compulsory membership under state law, such as the State Bar of California,[14] can serve as possible models. These efforts might not bear significant fruit and could pave the way for direct government regulation of program selection and grant making. Despite such drawbacks, however, the narrowness and the unresponsiveness of some private foundations demand such experimentation. Two of the principal goals of such experimentation should be to encourage the voluntary broadening of foundation management and greater foundation responsiveness to the controversial and changing needs of our society.[15]

Limits on Control But Not on Size

While it does not at present seem necessary to limit the size or life of private foundations, there should be limits placed on the time during which a donor and related parties or donees may at first control, and later substantially influence, the conduct of the private foundation. To encourage new ideas and approaches, and to avoid prolonged control by persons falling outside the donor and related-party group, it may also be necessary to place limits on the term of any single director.

Equal Tax Treatment for Foundations and Other Charitable Institutions

Finally, in order to promote the continued growth of private foundations and to eliminate the stigma attached to them, the present tax distinctions between private foundations and other charities should be abolished. Donors to private foundations should be entitled to the same tax benefits now given to donors to other institutions; private foundations should not be subject to heavier taxes or auditing fees than other charitable organizations; and many of the existing prohibitions such as that against self-dealing and control of business now imposed on private foundations should logically be extended to all charitable institutions. Elimination of existing legal differences between private foundations and other charitable institutions is needed not only to remove an unfortunate stigma on foundations, and not only to eliminate the unwise distortion of charitable giving which such distinctions may create, but also because these existing distinctions themselves invite further discrimination, representing as they do a kind of legislative presumption of inferior status.

III

AREAS OF POTENTIAL GOVERNMENT REGULATION: THE PROBLEM OF "PRIVATENESS"

Solicitation of Funds

By definition the private foundation obtains funds from a single donor or family. To require public funding or to otherwise restructure the support base would destroy the very nature of the private foundation. While there are admitted virtues to the contention that publicly supported charities must continually prove themselves in order to maintain a flow of donations, one of the unique aspects of the private foundation is its independence from such popular support. This makes the foundation less likely to be subject to public passions and prejudices of the moment than almost any other institution in our society. Even the wealthiest private university knows that "money [of its donors] talks." Therefore, any suggestions that foundations be required to solicit at least some funds from the public sector or perish is a route to "publicness" that should not be considered.

Selection and Composition of the Governing Board—Donor Control

Only a limited amount of direct governmental intervention can be safely brought to bear on the composition of governing boards of private foundations without destroying the independence of existing foundations and without negatively affecting the establishment of new foundations. Some objective legislative limits restricting only the scope and duration of donor- and donee-control may be tolerated. These legal minima could be supplemented by semiprivate mechanisms that would indirectly seek to accomplish goals not safely attainable through direct legislation or direct governmental regulation.

The governing boards of foundations must be nondemocratic. They must remain so if they are to provide any alternative to the political establishment. This necessarily involves a certain risk of "narrowness." Yet, for foundations to play a significant role they must be prepared to respond to changing times and needs. They must therefore continuously seek to broaden their outlook either through changes in their staffs or their boards or at least through the scope and outlook of their grant-making programs. In sum, they must endeavor to act in a "public" and "responsive" fashion (even though such concepts are not amenable to precise definition) or their future will not be secure. More importantly, unless they so behave they will not fulfill the promise of their role as an independent source of power on the frontiers of charity, probing new and controversial causes, to give new strength and vitality to a democratic society and to challenge the democratic majority and the conventional wisdom.

Furthermore, if any single factor preponderates in subjecting foundations to political criticism, it is the image of nondemocratic control by the donor or his surrogates. Donor control or substantial influence on a board creates, at least, apparent possibilities for selfish operation and self-dealing. The rules promulgated by the Tax Reform Act of 1969,[16] extensive as they are, have not eliminated the possibility. One of the key elements of the Tax Reform Act of 1969 is section 4943 which imposes a penalty tax on certain excess business holdings and which is designed to prevent foundation control of business. Section 4943 was recommended by the Treasury Department and adopted by the Congress on the theory that foundation control of business can be harmful because, among other reasons, it affords the opportunity for very subtle and difficult to detect forms of self-dealing. It was for similar reasons that the 1965 Treasury Department report recommended that control of foundations by donors be limited to a twenty-five year period:[17]

> It [the proposed limit on donor control] would limit the time period within which abuses could occur through the exercise of substantial donor influence; and, by assuring the donor that his actions would ultimately be subject to independent review it would tend to protect the foundation from abuse even during its first 25 years. By enabling independent private parties to evaluate the performance and potentiality of the foundation after 25 years of operation and granting them power to terminate the organization, then or later, the measure would provide a method for eliminating foundation[s] which have doubtful or minimal utility. Finally, in broadening the base of foundation management, the recommendation would bring fresh views to the foundation's councils, combat parochialism, and augment the flexibility of the organization in responding to social needs and changes.[18]

The Congress did not act affirmatively on this recommendation. However, for the reason above cited, the same kind of recommendation is made here.

More specifically, the recommendation has two main parts: (1) adopt a gradual reduction of donor and related-party presence on the board, and (2) limit the term of any person other than the donor. Substantial donees[19] of the foundation and essentially nonindependent persons such as direct or indirect employees, attorneys, accountants, and bankers of the donor or his family should also be included within the related-party category. Since the details of such a recommendation cannot be derived from pure logic but must be based on a subjective balancing of objectives, the rules sketched out below are suggestions to demonstrate the kind of details that implementation of the main recommendations would entail.[20]

Slightly different rules would be needed for inter vivos contributions and for contributions made on the death of the donor. In the case of a donor who created a foundation and funded it during his lifetime, the donor himself could be allowed to remain on the foundation board for his lifetime. This would leave unimpaired a significant motivation for the formation of foundations by wealthy donors. On the other hand, the make-up of the board should be limited as follows in the case of such inter vivos foundations:

1. "Control" of the board by the donor and related parties should be eliminated after a relatively short period of time such as seven and one-half years. Persons within the "donor group" should be defined even more broadly than the category of "disqualified persons" under existing law and, in particular, to include substantial donees of the foundation. "Control" could be defined as the ability to cause the foundation to act (normally evidenced by more than 50 percent of the voting power of the board or other governing body).

2. After relinquishing control, the donor group as defined above would be allowed "substantial influence" on the board for another period of seven and one-half years. "Substantial influence" could be defined as more than 20 percent, but less than 50 percent, of the voting power of the board. Thereafter, only less than substantial influence would be permitted.

3. In any event, the terms of all persons serving on the board (except the principal donor) would be limited to a period of no more than five years, with no possibility of reappointment. In some cases, this might result in the elimination of donor control and substantial influence over a shorter period than stipulated above.

In the case of foundations that are substantially created by testamentary gifts, the following should apply:

1. So that the donor has some assurance that his charitable goals will be carried out, it might be reasonable to allow his immediate family to control the foundation for the same seven and one-half year period specified for inter vivos foundations. The "immediate family" would be limited to the donor's spouse, children, and grandchildren.

2. There appears to be no compelling policy reason to allow other, more remote, donor-related parties (such as his attorneys, accountants, or business employees) to control the foundation after the donor's death or to play any substantial role in assisting the immediate family in its initial control role. Therefore, during the initial seven and one-half year period these other disqualified persons could serve, along with the immediate family, in the capacity of a control group, but should themselves be limited to no more than 20 percent of the board.

3. After the initial seven and one-half year period following the donor's death and the creation of the foundation, the donor's family together with other disqualified parties would be allowed no more than substantial influence (more than 20 percent, but less than 50 percent, of voting power) on the board for another seven and one-half years. Thereafter, only less than substantial influence would be permitted.

4. The terms of all board members would be limited to one five-year term, with the possible exception of the donor's spouse, children, and grandchildren who, as surrogates of the donor, might be allowed to serve more than five years (perhaps ten years) but not a lifetime. In any event, this exception should not be used to circumvent the provisions requiring no control after seven and one-half years and less than substantial influence after fifteen years.

These periods of permitted donor control and substantial influence should be sufficiently generous so as not to interfere significantly with the principal donor's motivation to impress a desired character on the foundation, and thus should not lessen the donor's incentives to create and fund the foundation. And yet these limits are an objective and enforceable way of dealing with one pressing aspect of the need to achieve publicness for foundations. Alone they will not ensure publicness, but at least they are an attempt to ameliorate one aspect of privateness. Such governmental regulation need not be an incursion on the foundation's independence; it merely limits the control of the foundation by one exclusive private group.

In addition to these suggestions for the gradual elimination of donor control and substantial influence over a fifteen-year period, strong anti-self-dealing, anti-business-control, and anti-accumulation rules (as contained in the Tax Reform Act of 1969) must be maintained. Full disclosure of foundation finances, grant-making procedures and results would also significantly improve foundation publicness.

IV

PRIVATE OR SEMIGOVERNMENTAL REGULATION OF BOARD COMPOSITION AND CONDUCT

Direct governmental regulation of the selection and composition of the board is generally inconsistent with the desired pluralistic and independent nature of the foundation. While all of the recommendations in the preceeding section would go a long way toward removing some of the actual and political weaknesses and vulnerabilities of the private foundation, foundations would still be susceptible to the charge that they are nonpublic and nonresponsive even when they are not controlled by the donor (or parties related in some way to the donor). These could be allegations that the composition of foundation boards is narrow in origin, background, outlook, and interests; that they are elitist, unimaginative, and unsystematic in setting priorities; that they are not accessible to some groups. Such characteristics, and especially the fact that foundation boards are not democratically representative, are not necessarily faults. Indeed, these characteristics may be virtues, since a foundation whose directors were chosen like legislators would present no real alternative to governmental support.

However, if it could be shown that these characteristics actually limit the foundation's ability to respond to public needs or its ability to provide a real alternative to public sector support, then such privateness would be not only a political disadvantage, but also diametrically in opposition to the avowed goals of the foundation in our society. Policy alternatives in this regard might be to

(a) dismiss the charges as minor imperfections which should be ignored since they will cure themselves over time and cannot be handled through any kind of regulation without seriously damaging the foundation;

(b) accept the charges as serious but limit their correction to nongovernmental methods of regulation, perhaps, with minimal intervention in providing "legitimacy" to otherwise private regulators; or

(c) treat the charges as serious and risk the damage that might ensue from direct governmental regulation.

The first course involves no action other than defensive argumentation and possibly vague exhortations to foundations to "do better." Little more can be said about this first alternative which involves a complex balancing of questions such as the political strength of the foundation and the seriousness with which one views governmental or private intrusion into this area. A realistic assessment would reject this "do-nothing" position as neither necessary for the preservation of the most vital aspects of foundations nor politically safe. Certainly no one would argue that there are *no* limits on who may be a fiduciary. For example, it would probably not be problematical if government were to provide that the following persons could not sit on a board: a minor, an alien, a convicted felon, an elected government official, a major supplier of services to the foundation, or a repeating and willful self-dealing board member.[21] Limits on the terms of fiduciaries and on the extent and duration of donor control are surely more serious matters but are still relatively mechanical regulations which need not involve direct governmental intrusion into foundation decision making. The third alternative must be rejected outright as simply inconsistent with the *raison d'etre* of the foundation.

The second alternative, limited private regulation, seems superficially attractive; however, the problems with this approach are also serious:

How could a private regulatory body be endowed with the "legitimacy" or enforcement sanctions necessary to make it effective?

How could it obtain independence from the persons and institutions it regulates?

Could it set any uniform and objective standards for behavior that would be useful and sensible?

As previously noted the Financial Accounting Standards Board in the accounting field is one possible model for self-regulation. However, the process of setting standards is extremely difficult in the foundation area. There is no single standard for correct behavior in program selection, grant-making, or in board composition, perhaps because foundations must be pluralistic in such respects—that is, promotive of differences, not uniformity. Moreover, even if regulations could be devised, there are no ready-made sanctions for failure to comply in the foundation area as there are in the accounting field. The American Institute of Certified Public Accountants can, as part of its rules of ethics, require its members not to certify statements that are contrary to the standards set by the Financial Accounting Standards Board. Furthermore, certain government agencies such as the Securities and Exchange Commission have also adopted certain of these standards thereby legitimizing them. In view of the lack of possible uniform standards, it is difficult to conceive of similar sanctions in the foundation field. Finally, it should be noted that there are already serious criticisms of the FASB which raise questions about its ability to act independently enough to fend off direct government regulation. Nor would any California lawyer be completely sanguine about the success of the California State Bar as a model of effective semiprivate regulation.

Nevertheless, because the charges of foundation privateness and narrowness are serious, such semiprivate models must be considered, and something like a Foundation Evaluation Board should be tried, at least on an experimental basis. Such a board could be given financial independence in several ways. It is conceivable that the largest foundations might agree to fund the activities of a Foundation Evaluation Board over an extended period, such as ten years. This would allow for the appointment to the board on a full-time, long-range basis of capable and independent persons. Their tenure could be sufficiently long—five to seven years, for example—to provide them with true independence. The financing could also provide for adequate staffing.

An alternative financing method would be to combine private regulation with some form of governmental participation in order to provide legitimacy. Such a course might require that all private foundations register with the Foundation Evaluation Board solely for the purpose of paying a certain amount of dues per year. Government could also help by making it mandatory to supply the board with needed data. Even if nothing further were done this would provide such a Foundation Evaluation Board with more prestige, legitimacy, and independence than if it were merely funded by the ten or twenty largest foundations.

While it would be relatively easy to provide some degree of independence through financing and tenure, selecting the board members of a Foundation Evaluation Board would pose more serious problems. Here one could conceive of a variety of sources of appointments that would guarantee a modicum of independence. Some members might be selected by the foundations themselves; others by the Secretaries of the Treasury and Health, Education and Welfare; still others by various associations of charitable organizations.

An adequately funded and legitimized board with adequate staff could develop, over an experimental period of ten years, useful functions for itself that would meet some of the challenges in this area. For example, it could draft standards for the fair and prompt processing of applications and for publicizing the areas of foundation interest and results of the award process; it could systematically gather information about the composition of foundation boards and key staff personnel; it could encourage broadening the areas of both foundation concern and governing board composition.

Setting up a board of this nature could pave the way for an eventual takeover of its functions by a government agency. Moreover, the very criticisms raised by this board might be used by some critics of private foundations as further evidence of the need to curtail or eliminate the foundation as we know it today. However, it is believed that these dangers are, on balance, worth risking in view of the dangers of a "do-nothing" policy.[22]

Moreover, government regulation can continue to play a role in the manner in which the board and key staff govern the foundation. A board essentially performs two major functions: first, it manages the foundation's funds and oversees budgetary planning; second, it selects areas of program interest and determines who will receive individual grants. Government can directly regulate the first function without detriment to the foundation's role. On the other hand, the very heart of the foundation is its independence in selecting areas in which grants will be made and in making the individual grants, and these must be kept free of government regulation and should be subjected, at most, to systematic, privately supported or semigovernmental evaluation and criticism.

V

COMMUNITY FOUNDATIONS: AN INAPPROPRIATE MODEL

Another possible policy alternative for regulating private foundations might be modeled on regulations now being developed by the Internal Revenue Service which would establish criteria to determine whether "community foundations" will be treated under the existing tax laws as publicly supported charities rather than private foundations. Many of these community foundations receive substantial amounts of their support from a limited number of donors and cannot meet the usual test for publicly supported charities. This approach would begin with a government definition of "publicness," dependent on a variety of factors. There would be several ways in which a private foundation might satisfy the requirements that it be "public." For example, possible factors would include the extent to which the foundation's directors are chosen by outside agencies, such as public officials or groups of donees; the extent to which the foundation seeks to raise outside funds; and the extent to which a foundation formally chooses its board members from different fields and different representative groups, such as clergymen, educators, civic leaders, or university officials.[23]

The comparison between community foundations and private foundations does not hold up under close analysis, however, and this alternative is probably inappropriate in the foundation sphere. Community foundations are essentially local institutions; they obtain funds from the general public, generally engage in rather noncontroversial charity programs of a local nature, and even where there is controversy there is often a tendency to move toward a consensus basis. Any effort to implement this kind of approach for private foundations would come dangerously close to democratizing them, which would undermine their role as an independent alternative, or would commit their funds to ongoing activities such as are the endowments of operating charities, which would seriously undermine the foundation's flexibility.

VI

LIMITATIONS ON MINIMUM OR MAXIMUM SIZE

Many critics claim that government-imposed limitations on foundation size—either on a minimum or a maximum basis—should exist. Some contend that small foundations are apt to abuse their public trust since they are too numerous and too difficult to police. Furthermore it is argued that they are not apt to do useful work in view of their limited funds and limited staffing. While this is a question of competing alternatives, many small foundations *have* been useful and *have* played an important role in the general scheme of foundation affairs. It appears most unwise to eliminate the small, but varied and unique, foundations without serious evidence that the government is indeed unable to police such foundations and that indeed they are wasteful. No such evidence is as yet available. In fact, government regulation already imposed by the Tax Reform Act of 1969 has proven to be too expensive and onerous for many small foundations, so much so that many have been terminated. And it is suspected that new ones have not been formed in view of the new requirements.[24]

As to maximum size, some would contend that it is unwise to give as much power to a single board as is now held, for example, by the board of The Ford Foundation. In view of the fact that many of the largest foundations have performed better than average, these charges are probably not substantial. There is no evidence that large foundations have acted less adventurously than the average medium-size foundations, nor that they have stifled or molded research to the detriment of the pluralism we seek. It would seem that we need more, not fewer, large foundations at the present time. Furthermore, it seems that like good wines, foundations also improve with age; generally the "horror" examples of the Treasury 1965 report and others are not the Carnegie and other "mature" foundations. If the previously discussed recommendations for regulating foundations are carried out, there would be no cogent reasons to limit the size of foundations nor to limit their life or duration.

VII

CONCLUSIONS

Since by definition the private foundation normally obtains its funds from a single donor or family, to require public support or to change in any way this source of funding would be to destroy the vary nature of the private foundation. To require such publicness is not a feasible or desirable alternative for the foundation as we know it. While little government regulation can be safely brought to bear in the area of selection of the governing board and management of a foundation without destroying its independence and without adversely affecting the creation of new foundations, some modest limits for restricting the scope and duration of donor control and influence might well be adopted. The benefits from such limits appear to outweigh the possible risks of such action or non-action.

Footnotes

1. These attributes have been described by the collective term "venture philanthropy."

2. See Liles & Blum, "Development of the Federal Treatment of Charities," 39 Law & Contemp. Prob. no. 4, (1975).

3. See generally Worth, "The Tax Reform Act of 1969: Consequences for Private Foundations," 39 Law & Contemp. Prob. no. 4, (1975).

4. Cf. the recommendation of the Commission on Private Philanthropy that a new category of "independent" foundation be established. See *Giving in America*, infra, note 6, at 172. "Such organizations would enjoy the tax benefits of public charities in return for diminished influence on the foundation's board by the foundation's benefactor or by his or her family or business associates." Under the recommendation, governing boards of such foundations would be restricted to at most a minority representation by the donor, his family and associates. In return, such organizations would not be subject to the limitations on giving that now apply to private foundations, including the ceiling of 20 percent of the giver's income that can be deducted from income taxes of gifts to private foundations, the restriction against endowment gifts from income of other foundations, and the exclusion from full eligibility to receive appreciated property that is deductible at market price. Ibid at 173.

5. For example, a donor, in the 50 percent marginal tax bracket, is able to give to the university of his choice $100 for each $50 sacrifice in after-tax dollars. For a discussion of the effect this has on giving see Kirkwood & Mundel, "The Role of Tax Policy in Federal Support for Higher Education," 39 Law & Contemp. Prob. no. 4, at nn. 81, 85 (1975). The other $50, tax savings, are monies which the donor is allowed effectively to designate to the university rather than paying directly to the government to be appropriated by the Congress. This latter element of present tax policy focuses on what is believed to be the central issue of foundation governance. The precise tradeoffs in terms of efficiency or equity of the tax (or other monetary) incentives to the donor and the desired level of total giving are beyond the scope of this paper, which will deal with only the second aspect: the "private appropriation" – or "private governance" – price that society may have to pay in order to sustain a desired level of giving to private foundations. This same non-monetary incentive may also be necessary in order to achieve and retain foundation independence and flexibility, the two characteristics that are believed to be their key values to society. The tradeoffs here are very delicately balanced, especially when independence and flexibility are at stake and a somewhat higher margin of safety may be called for than in the case of the monetary (tax) incentives.

6. The many independent studies sponsored by the Commission on Private Philanthropy and Public Needs are good examples of this potential role. For a list of these studies see Commission on Private Philanthropy and Public Needs, *Giving in America: Toward A Stronger Voluntary Sector*, app. 1 (1975) [hereinafter cited as *Giving in America*]. The Commission also sponsored a "Donee" Group, a coalition of public interest, social action, and volunteer groups. This group published its own report entitled "Private Philanthropy: Vital and Innovative, Or Passive and Irrelevant?" (1975) [hereinafter cited as Donee Group Report].

7. See, for example, the recommendation of the Commission on Private Philanthropy and Public Needs "that all tax-exempt organizations be required to maintain 'arms-length' business relationships with profit-making organizations or activities in which any principal of the exempt organization has a financial interest. . . (and) that a system of federal regulation be established for interstate charitable solicitations and that intrastate solicitations be more effectively regulated by state governments." *Giving in America* at 24-25. The Commission also

recommended that larger tax-exempt organizations except churches and church affiliates "be required to prepare and make readily available detailed annual reports on their finances, programs and priorities" and further that "larger grant-making organizations be required to hold annual public meetings to discuss their programs, priorities and contributions." The Donee Group also recommended expanded public information requirements and annual public meetings. See Donee Group Report. In both cases the recommendations for disclosure and public accountability would expand the requirements now imposed on foundations and would extend them to cover almost all charitable organizations.

8. For a complete synopsis of these regulatory provisions see Worthy, supra, note 3. See also Wadsworth, "Private Foundations and the Tax Reform Act of 1969," 39 Law & Contemp. Prob. no. 4., (1975).

9. Attempts to provide absolute assurance that dollars committed to private foundations will not be diverted to personal uses or spent in a narrow – i.e., not truly public – and unresponsive way will destroy the very reason for the existence of the private foundation. An essential and vital function of the private foundation in our society is to provide venture capital to initiate and support activities in new and controversial areas where government will not, or cannot, provide assistance. Under these circumstances, some degree of elitism is natural, some "slippage" will occur, and many mistakes will be made – just as all of these imperfections occur daily in governments, in private enterprise, and in publicly supported charities.

10. Examples abound: consumer law firms which challenge unfair business practices in the courts; public auditors, such as Tax Analysts and Advocates – successful low-budget critics of the Internal Revenue Service, the Treasury Department, and the Congress, whose persistent and careful efforts led to the audit of President Nixon's tax returns; the Brookings Institute which presents in an objective, scholarly fashion alternative courses of action for governmental fiscal and economic policy.

To some extent both the Commission on Private Philanthropy and Public Needs and the Donee Group recognized the need to expand foundation grants in these areas. There was a difference of emphasis, however. The Donee Group Report states that "although the Commission recognizes the support of organizations such as these to be one of 'the enduring pragmatic functions seen for non-profit organizations,' it does not make recommendations to remedy the lack of support which these issues and organizations have received from the non-profit sector."

11. See Worthy, supra, note 3; Wadsworth, supra, note 8.

12. See the recommendation of the Commission on Private Philanthropy and Public Needs: "That nonprofit organizations, other than private foundations, be allowed the same freedom to attempt to influence legislation as are business corporations and trade associations, that toward this end Congress remove the current limitation on such activity by charitable groups eligible to receive tax-deductible gifts." Giving in America at 26. See also the recommendations of the Donee Group Report.

13. The Financial Accounting Standards Board is voluntarily financed on a long term basis by the ten largest accounting firms.

14. All practicing attorneys must maintain dues paying membership. The Bar in turn carries out, among many other activities, regulation of ethical practices of attorneys.

It is interesting to note that, effective January 1, 1976, California law requires that six non-attorneys be added to the California Bar's Board of Governors, apparently a first for any governing body of an American Bar. Cal. Bus. & Prof Code §6013.5 (West Supp. 1976). The six lay persons will be appointed by the Governor of California subject to confirmation by the California Senate. The new law also requires two lay members each on the Committee of Bar Examiners and the Disciplinary Board of the State Bar.

15. Both the Commission on Private Philanthropy and Public Needs and the Donee Group strongly urge these two recommendations, the Commission by exhortation and the Donee Group "by law." The Commission feared that the latter would "undermine an important distinction between the voluntary sector and government." The Donee Group, impatient with exhortation, claimed that compulsory expansion of governing boards to include significant representation from the

"general public," "non-profit agencies," and "in particular women and minorities" would "actually make philanthropy more pluralistic." Notwithstanding the Donee Group's claim, this concept of "pluralism" is not pluralism but is either "democratic representativeness" or "proportional representation," in either event an entirely different matter and, as noted by the Commission, essentially not distinguishable from government. Aside from definitional arguments, the Donee Group unfortunately makes the frequent mistake of those impatient with the pace of democratic progress when they confuse means and end. The Donee Group is concentrating on end results. However, if they choose the means of forcing democratic or proportional representations on philanthropy they might just as well direct their efforts to government and do away with private philanthropy, having done away with its essential characteristics, namely, independence from such government interference.

16. The Tax Reform Act of 1969, Pub. L. No. 91-172, 85 Stat. 487, added chapter 42, sections 4940-48 to the Internal Revenue Code of 1954, which rival in their complexity such notable areas of the Internal Revenue Code as subpart F dealing with "tax haven" corporations and, more recently, the provision of the Employees Retirement Income Security Act of 1974, 88 Stat. 829 (codified in scattered sections of 5, 18, 26, 31, 42 U.S.C.). These rules provide a comprehensive pattern of prohibitions and control of foundation behavior enforced through a series of sanctions in the form of severe penalty taxes.

17. U.S. Dept. of Treasury, 89th Cong., 1st Sess., Report on Private Foundations 57 (Comm. Print 1965).

18. Ibid.

19. Defined as a donee that received more than 5 percent of the foundation's total grants for the year or for the last "x" number of years.

20. In this regard compare the recommendations of Sen. Edward Kennedy, the Donee Group, and the Commission. It is the recommendation of Sen. Kennedy that, after the first 25 years of existence of the foundation, the creator and members of his family be limited to 25 percent of the membership of the managing board of the foundation. In the case of organizations in existence for more than 10 years, the period would be 15 years from the effective date of the new law. 122 Cong. Rec. 3755 (daily ed. March 18, 1976). Senator Kennedy noted that "[a]lthough the recent [Commission on Philanthropy] study did not make any specific recommendations to restrict donor control of private foundations, the above proposal is consistent with its statement that Congress examine the issue. The Commission did espouse 'the general view that openness and accessibility are as important for donor-controlled foundations as for other philanthropic, non-profit organizations. If, in any particular organization, relinquishing a degree of donor control serves to further the cause of greater accessibility, then the course should, we feel, be positively pursued.'" Ibid at 3761. While Sen. Kennedy's recommendation would move more slowly than that recommended herein, the impatient Donee Group recommended that the governing boards of all foundations be required by law "to have no less than 1/3 public members immediately and no less than 2/3 public members after 5 years. Public members would be defined negatively to eliminate donors, their relatives and business associates."

21. While these latter rules are undoubtedly less objectionable even to the most ardent opponent of government interference, it must be stated that it is not here suggested evidence that such persons are today sitting on boards.

22. The Donee Group, evidencing a rather short memory considering the relatively recent Watergate experience, criticized the Report of the Commission on Private Philanthropy and Public Needs because "fear of government pervades the Report." Even were not the experiences of Watergate so fresh in our memories, it should be easy to recall that the basic reason for philanthropy, and in particular for the private foundation, is as an alternative to government. Fear of government intervention is thus quite sensible. The Donee Group also criticized the Commission for excessive confidence in self-regulation. The Donee Group dimly remembered Watergate when it recommended the removal of the supervisory function regarding exempt organizations from the IRS and the creation of a new, independent regulatory commission with a presidentially appointed board reflecting all elements of private philanthropy, including donees. It forgets that Watergate can reach even agencies such as the SEC. It also recommended a permanent standing committee in the House and Senate having oversight responsibility over such an agency.

The Commission recommended that a permanent national commission on the nonprofit sector be established by Congress whose role would be to continue, in effect, the work of the Commission itself. One half of the commission's membership would be named by the President, subject to Senate confirmation, and the other half by the presidential appointees themselves. Funding for the commission would come half from government, half from private sources. See Stone, "Federal Tax Support of Charities and Other Exempt Organizations: The Need for a National Policy," U. So. Cal. 1968 Tax Inst. 27, 77.

23. See Proposed Treas. Reg. §1.170A-9(c)(10)-(19), 36 Fed. Reg. 19598 (1971) and Proposed Treas. Reg. §1.507-2(a)(8), 36 Fed. Reg. 19601 (1971).

24. See Worthy, supra, note 3.

Part III

Corporations

CORPORATE PHILANTHROPIC PUBLIC SERVICE ACTIVITIES

James F. Harris[†] and Anne Klepper*

Foreword

Voluntarism and private philanthropy are deeply rooted in our tradition. In recent years the U.S. corporation and its employees have been major factors in preserving that tradition. Currently, corporations contribute about $1.25 billion annually to various charitable organizations; their philanthropy-related business expenses and the time their employees at all levels contribute to public service activities are valued at roughly up to 1 billion dollars.

What motivates corporate giving and public service activity? Are these activities principally public relations efforts or are there other motivating forces at work? What is the impact of existing tax incentives for corporate philanthropy? Do the tax and other incentives have an equitable impact on different classes of corporations, regulated and other? These are among the questions this study begins to explore. It is a first effort of this kind, not a definitive examination; it opens as many new questions as it resolves.

The study reported on here received partial funding from the Commission on Private Philanthropy and Public Needs. In addition to presenting data on the types of corporate philanthropic and public service activities and the amounts expended on them, it explores the role of the chief executive officers, chairmen and presidents in determining their corporations' responses in this area.

The questionnaire used in this study was developed in cooperation with Yankelovich, Skelly and White, Inc. This report also includes recommendations to the Filer Commission developed by a Business Advisory Committee, members of which reviewed and interpreted the study findings.

The Conference Board and the authors are grateful to the members of the Business Advisory Committee for their guidance throughout the research process, to Ruth Clark of Yankelovich, Skelly and White, Inc., for her aid, and to the chief executives and corporate philanthropy directors who made available the information for this study. Special thanks are extended to Conference Board staff members Luke McSherry and Michael Papantoniou for providing extensive computer services, and Lillian W. Kay for invaluable editorial assistance.

David G. Moore, Acting President, The Conference Board

I

INTRODUCTION

Just over 20 years ago, the New Jersey Supreme Court upheld the legality of a corporate contribution to Princeton University in the landmark decision in the case of *A.P. Smith Manufacturing Company v. Barlow.* The Supreme Court of the United States dismissed the appeal, allowing the decision to stand. The New Jersey Supreme Court said, in part:

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". . . the contribution here in question is towards a cause which is intimately tied into the preservation of American business and the American way of life. Such giving may be called an incidental power, but when it is considered in its essential character, it may well be regarded as a major, though unwritten, corporate power. It is even more than that. In the Court's view of the case it amounts to a solemn duty."

What is the prevailing situation today? What are the motivations for corporate public service activities that are philanthropic in nature? What are the incentives – and disincentives – for corporate contributions? What is the extent of corporate philanthropic public service activities? These are some of the questions this study attempts to answer.

Corporate Roles and Philanthropy

Historically, corporations have fulfilled their obligations to society by concentrating on their principal function, which is economic. In the last quarter of the 20th century, however, society increasingly appears to be expecting business to exhibit social concern per se. On the one hand, a variety of laws and regulations mandate expenditures that total hundreds of billions of dollars a year. Some of these mandated activities require the transfer of income by the payment of taxes – social security, welfare, unemployment insurance, for example; others – such as compliance with safety codes, cleaning up the air and water, providing employment opportunities for women and minorities – require direct expenditures. Some companies, of course, voluntarily assumed (and still voluntarily assume) obligations of this nature, as witness the growth of employee benefits.[1]

As mandated costs for a variety of social programs increase, there is a tendency to lose sight of voluntary assumption of social obligations. Corporate philanthropy may be small when compared with such mandated costs, but it represents the American heritage of voluntarism in principle – and a not inconsiderable number of dollars in practice. Most easily identifiable are the contributions to charitable organizations reported to the Internal Revenue Service. For 1974, such corporate contributions were estimated at $1.25 billion. In addition, business expenses that benefit philanthropic activities (for example, cash grants, donated time of employees, cost of special employment programs for drug addicts and ex-convicts, use of corporate facilities, loans at less than market rates) are estimated to total up to another billion dollars annually. And company participation in United Funds, including payroll deduction, yields an additional $450 million from individual employees.

The mood in which corporate responsibility for voluntary philanthropy is accepted is summarized in these typical statements from three chief executives participating in the study.

"I am convinced that the health of any corporation depends intrinsically on the social, as well as the economic, vitality of its environment – in the city, in the nation, and around the world. Thus it is in the enlightened self-interest of a corporation to support important public service undertakings."

– Chief executive officer of a major bank

"The alternative to effective participation by all segments of the private sector – institutions as well as individuals – is government. For many problems, government programs are ineffective at best. The corporate community exists at the sufferance of the public; and if public expectations are not met, the corporate sector will tend to fail."

– Chief executive officer of a major insurance company

> "The corporation has a responsibility to contribute from its income to public programs of education and community welfare as a good citizen. Business management has sound judgment on needs, and can contribute to efficient management of funds."
>
> – *Chief executive officer of a major energy company*

Corporate Contributions, 1936 – 1972

Table 1 summarizes corporate contributions reported to the IRS as charitable deductions from 1936 – the first year in which such reports were made – to 1972, the last year for which IRS data are available. Fluctuations with profits notwithstanding, from 1961 to 1972 contributions have averaged almost 1.1 percent of net pretax income.

There is a three-year lag before the publication of these data by IRS. It has been estimated, however, that contributions increased to $1.14 billion in 1973 (0.97 percent of pretax income) and $1.25 billion in 1974 (0.95 percent of pretax income).[2] Contributions for 1975 may return to the one percent mark.

Stockholder Influence

As the challenge to corporate philanthropy that led to the New Jersey Supreme Court decision in *A.P. Smith Manufacturing Company* v. *Barlow* was a suit brought by a stockholder, it is interesting to note present-day evaluations of stockholder reaction to corporate philanthropy. Of 417 chairmen and presidents responding to the questionnaire, 88 percent say that stockholders have "no real influence" over the level of the company's contributions. Among the 33 companies whose top officers say that stockholders *do* influence the level of the contributions budget, in 8 cases this is in the direction of increasing the budget; in the remaining 25, the effect is a smaller budget – or no further increase.

Four hundred chairmen and presidents rated stockholders' reactions to the company's contributions programs. Of those, 70 percent indicated that there were "no stockholder reactions." Among those who did report reactions, 22 percent assessed them as "mainly favorable"; 5 percent as equally divided between favorable and unfavorable; and 3 percent as "mainly unfavorable." Four hundred and six chairmen and presidents answered a question on whether any apprehension over possible negative reactions from stockholders tended to keep the dollar level of contributions from growing larger. Eighty-six percent replied in the negative. Responses to these two questions suggest the possibility that corporate philanthropy per se is no longer a controversial issue. However, one quarter of the leaders in the survey said they would increase contributions if they thought that the stockholders approved. This, in turn, suggests that the lack of controversy relates to present levels of philanthropic activity but might not apply to higher levels. These data reflect the impressions of top management.

Shareholders have accepted contributions as an integral part of a corporation's activities. In the few cases where contributions have been challenged in the courts by shareholders, the challengers have rarely gained as much as 3 percent of the stockholders' vote. In addition, institutional investors – including colleges, universities and foundations, many of whom would encourage corporate contributions – constitute a major proportion of shareholders.

Cost to Stockholders

Costs to the shareholder have been modest, as the following data show. Contributions as a percent of pretax income have averaged about one percent for all

Table 1

Corporate Contributions and Corporate Net Income Before Taxes

		Contributions	
Year	*Net Income Before Taxes*[a] *(in millions)*	*Amount (in millions)*	*As Percent of Net Income Before Taxes*
1936	$ 7,771	$ 30	0.39%
1937	7,830	33	0.42
1938	4,131	27	0.65
1939	7,178	31	0.43
1940	9,348	38	0.41
1941	17,700	58	0.33
1942	21,500	98	0.46
1943	25,100	159	0.63
1944	24,100	234	0.97
1945	19,700	266	1.35
1946	24,800	214	0.87
1947	31,500	241	0.77
1948	35,200	239	0.68
1949	28,900	223	0.77
1950	42,600	252	0.59
1951	43,900	343	0.78
1952	38,900	399	1.03
1953	40,600	495	1.22
1954	38,300	314	0.82
1955	48,600	415	0.85
1956	48,800	418	0.86
1957	47,200	419	0.89
1958	41,400	395	0.95
1959	52,100	482	0.93
1960	49,700	482	0.97
1961	50,300	512	1.02
1962	55,400	595	1.07
1963	59,400	657	1.11
1964	66,800	729	1.09
1965	77,800	785	1.01
1966	84,200	805	0.96
1967	79,800	830	1.04
1968	87,600	1,005	1.15
1969	84,900	1,055	1.24
1970	74,000	797	1.08
1971	83,600	865	1.03
1972	99,200	1,009	1.02

a. Reflects total consolidated corporate net income before taxes.

Sources: Department of Commerce, Internal Revenue Service, The Conference Board.

corporations from 1961 to 1974. However, based on a 48 percent tax rate, almost half of the contributions would have been spent as taxes if the company did not make deductible contributions. The federal government encourages corporate contributions through tax incentives that can be looked upon as a type of matching grant program in which the federal government pays approximately half and the companies pay the other half. Dividends to shareholders would represent a much smaller part of the company's share.

Survey Methodology

The findings in this study are based upon the views and practices of 457 major U.S. corporations. The Conference Board, in consultation with Yankelovich, Skelly and White, Inc., and a Business Advisory Committee, designed a two-part, self-administered mail questionnaire which was sent to the 1974 *Fortune* magazine 1,300 list – the 1,000 largest U.S. industrial corporations, and the 50 largest commercial banking, life insurance, diversified financial, retailing, transportation, and utility companies. Part I was to be completed by the corporation's chairman or president, and Part II was to be forwarded to the professional person in the company knowledgeable about contributions and public service activities. The survey findings were supplemented by a series of personal interviews, analysis of extensive corporate literature, review of other pertinent studies, and evaluations by the Business Advisory Committee.

The *Fortune* 1,300 list was selected because:

- It is a commonly accepted and well-defined list of companies for research purposes.

- The listed companies have historically contributed the vast majority of philanthropic funds reported to the Internal Revenue Service.

- Supplemental data from other Conference Board studies could be used to enrich the interpretation of this survey as the target populations were similar.

The findings are based on information from 457 major corporations (a 35 percent return). Questionnaires were returned by 417 chairmen or presidents (78 percent of whom are also chief executive officers), and by 445 other management personnel.

For purposes of this survey, public service activities that are philanthropic in nature include:

- *corporate contributions and/or company foundation grants*

- *business expenses that benefit philanthropic activities,* such as cash grants, donated time of employees, additional costs of special employment programs (hiring drug addicts, ex-convicts, and so forth), and the use of corporate facilities

- *other programs,* including loans at less-than-market rates, price subsidies.

The members of the Business Advisory Committee were:

Kenneth Albrecht
Vice President
Corporate Affairs
The Equitable Life Assurance
Society of the United States

Henry M. Boettinger
Director of Corporate Planning
American Telephone and
Telegraph Company

Henry R. Brett
Corporate Contributions Counselor
Standard Oil Co. (California)

Lowell Harriss
Professor of Economics and Consultant to the Tax Foundation, Inc.
Columbia University

William Herbster
Senior Vice President
First National City Bank

James Hosey
Vice President and Executive Director
U.S. Steel Foundation, Inc.

E.B. Knauft
Vice President, Corporate Social Responsibility
Aetna Life & Casualty

H.C. Roser, Jr.
Manager, Community Development Programs
Exxon Corporation

Gabriel G. Rudney
Director of Research
Commission on Private Philanthropy and Public Needs

Hayden Smith
Vice President
Council for Financial Aid to Education, Inc.

Wayne Thompson
President
Dayton Hudson Foundation

II

LEADERSHIP

From the survey returns, analysis of extensive corporate literature on social responsibility, and discussions and interviews with corporate executives, two major concepts of corporate leadership emerge.

The first is the importance of the involvement of corporate leaders (especially chairmen and presidents) in upgrading all areas of corporate public service. This includes a wide range of financial and manpower contributions, plus concern for the quality of program content. This type of leadership is not "letterhead leadership." It involves commitment — both philosophical and practical.

The second, which emerges naturally from the first, is that there are "leading edge" practices in this area — just as there are in most other areas of management concern. These leading companies are far ahead of the vast majority of firms — in their respective industries or of similar size — in terms of both the size and the quality of programs. In addition, trade associations and industry groups play an important leadership role in upgrading public service activities by gathering data, stimulating a higher level of dollar contributions, encouraging more extensive use of personnel loaned to nonprofit organizations and governmental entities (such as school systems), and encouraging cooperation in public service causes.

Involvement of Top Corporate Leaders

The importance of top leadership — chief executive officers, chairmen, and presidents — in influencing the size and quality of a corporation's philanthropic activities is typical in all aspects of a firm's relationships to outside publics.[3] It may be enhanced in this area because of personal interests.

The Corporation's Social Role

Forty-five percent of the corporate chairmen and presidents responding to the Conference Board survey believe that " the corporation *should be a leader* in public service activities because this is required for its long-range success and survival." An equal number subscribe to the idea that "the corporation should engage in *more than the minimum amount* of public service activities because such activities can benefit the corporation." Thus, nine out of ten of these respondents endorse public service activities – against less than one percent who take the position that business should adhere strictly to its traditional economic role (see Table 2).

Table 2

What the Corporation's Social Role Should Be and What Present Role Actually Is
(Responses of 388 chairmen and presidents)

	Role Corporation Should Follow	*Corporation's Actual Present Role*
	Percent	*Percent*
The corporation should adhere strictly to its traditional role of providing products or services to customers at a maximum profit for the owners rather than engage in voluntary public service activities.	0.7	*
The corporation should engage in the minimum amount of public service activities essential to maintain satisfactory relations in the communities where it conducts its business.	9.3	17
The corporation should engage in more than the minimum amount of public service activities because such activities can benefit the corporation.	45	53
The corporation should be a leader in public service activities because this is required for its long-range success and survival.	45	30

*Less than 0.5%.

As the table also shows, there is a discrepancy between the evaluations of what top corporate leaders believe the company's role *should be* and what it now *is*. While 45 percent of the respondents believe that their companies should be leaders, only 30 percent feel they are. On the other hand, more than half the presidents and chairmen believe that their companies are doing "more than the minimum" – a goal also subscribed to by 45 percent.

Most Important Philanthropies

The philanthropic organizations with which corporate leaders are personally associated run the gamut of voluntary activity in the United States. Most of the respondents are engaged in the basic triumvirate of voluntary activities – health, education, and welfare – with a major emphasis on participation through federated campaigns (such as United Funds, Community Chests).

When these corporate leaders were asked to list the three organizations considered most important (of those with which they were associated during the past year as a board or committee member, as a member of a fund-raising campaign, and so forth), educational institutions dominated (see Table 3). The involvement of one out of every two respondents in United Way activities reflects the fact that businessmen have been instrumental in establishing such federated campaigns in order to bring professionalism and coordination to fund-raising activities. In their support of the arts, top executives may again be taking a leadership role: Nineteen percent of the respondents rank the arts among their top three philanthropic interests although only four cents of every 1972 contributions dollar went to such cultural activities.

Table 3

Organizations Considered Most Important
(Responses of 334 chairmen and presidents)

Organizations	*Percent of Executives Involved*[a]
Education:	
Universities and colleges	48%
Educational groups (United Negro College Fund, the Council for Financial Aid to Education, etc.)	18
Secondary and primary schools	5
Total Education	71
United Way organizations: United Funds, Community Chests, Councils	50
Health:	
Hospitals	18
Health agencies, other medical activities	11
Total Health	29
Cultural activities (museums, performing arts, nonacademic libraries)	19
Youth agencies	16
Urban affairs and minority activities	12
Foundations	12
Religious organizations (Catholic Charities, Protestant Council, Jewish Federation) and churches	11
Economic development groups	6
International organizations	5
Other charities (Salvation Army, Goodwill Industries, etc.)	5
Other organizations (public television, environment, community centers, population control, law and justice, etc.)	15

a. Percentages do not add to 100% because of multiple responses.

Philanthropic Activities

America's corporate chiefs lead and participate in a wide variety of philanthropic causes and devote a substantial amount of time to public service activities. They serve as chairmen or members of innumerable boards, fund-raising drives, planning and financial committees.

Tables 4 and 5 summarize the data on the number of philanthropic organizations they were associated with in the past year and the amount of time spent on such activities. The middle 50 percent were active in 3 to 6 organizations. On the average, these individuals spent 6.8 hours a week – equally divided between their own and company time – on philanthropic interests. Some corporate leaders point out that it is difficult to distinguish between hours of personal time and hours of company time devoted to philanthropy.

Table 4

Number of Philanthropic Organizations Associated With During the Past Year
(Responses of 384 chairmen and presidents)

Number of Organizations	*Percent*
None	8%
One	5
Two	12
Three	14
Four	11
Five	12
Six	13
Seven	7
Eight	6
Ten	5
Twelve	3
Fourteen	1
Eighteen	1
Twenty	1
Twenty-five	1
	100%
Mean (arithmetic average)	5.3
Median (midpoint – equal number above and below)	4.0

Some Leadership Examples

There is evidence that strongly committed corporate leaders exert a potent influence outside their own companies – on their respective industries, business-related organizations, peer companies of comparable size, and on other businesses in the community. Some examples of the tone and dimensions of such examples are presented here.

- One company, which has contributed 5 percent of its taxable income each year for 30 years, has encouraged other companies to commit themselves to this goal over a period of years. Approximately 10 major companies in the Midwest have joined this "Five Percent Club."

Table 5

Average Number of Hours Per Week Devoted to Public Service Activities
(Responses of 378 chairmen and presidents)

	Percent[a]	
Hours per Week	*Company Time*	*Own Time*
0	6%	7%
1	18	20
2	21	19
3	15	15
4	14	12
5	13	13
6	3	5
7	*	1
8	4	4
10 or more	5	5
Mean	3.4	3.4
Median	3.0	3.0

*Less than 0.5%.

[a] Do not add to 100% because of rounding.

- Not as ambitious, but of significant note, is the Corporate One Percent Program for Higher Education, which includes more than 100 companies. It is being promoted on a national basis and seeks to gain corporate support for contributing one percent of domestic taxable income to higher education alone. This does not include moneys given to health, welfare, civic and arts activities. No percentage is set for these.

- The insurance industry's $2 billion inner-city Urban Investment Program in the late 1960s and early 1970s, as well as its current $45 million program to finance ambulatory care centers in conjunction with $30 million in grants from the Robert Wood Johnson Foundation, illustrates an industry's leadership.

- Business-related organizations and industry groups have played an important leadership role in upgrading public service activities and in encouraging cooperation in public service causes. The activities of the Economic Development Council of New York City, which seeks to solve problems of government, is an outstanding example. In one year, New York-based corporations loaned the Economic Development Council the equivalent of 50 full-time executives to work on city governmental problems. The salaries of loaned personnel were paid by the corporations at a total one-year cost of $1.5 million. Budget savings of $78 million per year were made as a result of their activities.

- While continuing to pay the employees' salaries, one corporation lends more than 100 employees to various colleges and universities; another company lends more than 100 employees to other social institutions.

- Leadership companies frequently contribute 1.5 to 3 times the percentage of pretax income as the average companies in their industries, and 3 to 5 times as much as the average of the bottom quartile.

The "Leading Edge"

The Internal Revenue Code allows corporations to deduct contributions to charitable organizations up to a maximum of 5 percent of the corporation's taxable income, with a five-year carry forward. Only a handful of major corporations give the maximum amounts allowed; they tend to be family-controlled companies. However, some 51,000 small companies contribute at the 5 percent level (with an average contribution of $7,100), according to "Corporate Giving Measurements," a paper prepared by Thomas Vasquez for the Commission on Private Philanthropy and Public Needs.

The average for all of the 1.7 million U.S. corporations has been approximately 1.1 percent of pretax net income from 1961 to 1972, the last year for which Internal Revenue Service data are available. Although contributions as a proportion of pretax income is one of the most widely used yardsticks of corporate philanthropy, it is not a perfect measure and should be used with care. Although it is helpful in making comparisons, it is not indicative of the quality of the programs supported nor does it include contributions in the form of business expense deductions (see Chapter V).

Possibly the most important problem with this measure, of course, has to do with the absolute amounts involved. A small company, as noted above, can reach the limit of 5 percent of taxable income by contributing $7,100 or less; a multi-million-dollar contribution from one of the largest companies, however, might not come anywhere near meeting this limit.

Table 6 illustrates the fact that there are marked differences in the percentages of pretax income contributed to philanthropy among the 25 largest donors in dollar amounts. In 1973, one company's contribution of $16.73 million represented 0.43 percent of pretax income; another's $16.76 million accounted for 1.62 percent of such income.

The survey sample (457 companies) reported on in this study is heavily weighted by large companies. Their aggregate gifts of $350 million account for almost one third (31 percent) of all corporate philanthropic contributions in 1973. The group as a whole nevertheless contributed only 0.74 percent of pretax net income – reemphasizing the difference between the dollar amount and the percentage definitions of "leading edge" contributions. When the reporting companies are grouped by asset size, there is the same lack of pattern as when net income alone is the basis for comparison (see Table 7).

III

THE REASONS FOR GIVING

While the size and quality of corporate philanthropy is primarily a reflection of the interest and enthusiasm of top corporate management, these individuals base their decisions on company-related considerations. There are corporate motivations for philanthropy – just as there are individual motivations – and in this instance the former are the prevailing influences. Motivations differ with subject area and may differ, sometimes markedly, from one grant to another.

In this survey, corporate leaders were asked to check *most important reasons from a company viewpoint* for undertaking contributions activities in three fields – United Funds, higher education, and the arts (see Table 8). Corporate citizenship and improving the business environment – two motivations with considerable overlap – understandably rank particularly high for United Funds – the "business-like" approach to community organizations and their need for funds.

In the area of higher education, manpower considerations dominate, reflecting a long-standing concern of U.S. business with the development of manpower

Table 6

Contributions of 25 Largest Dollar Donors as Percent of Pretax U.S. Net Income, 1973

Company	*Contributions Dollars*	*U.S. Net Income Before Taxes*	*Contributions as Percent of Net Income Before Taxes*
1.	$18,082,083	$ 574,600,000	3.15%
2.	16,762,400	1,034,250,000	1.62
3.	16,730,702	3,920,000,000	0.43
4.	11,981,760	1,113,402,000	1.08
5.	11,100,000	1,382,000,000	0.80
6.	9,701,966	1,326,000,000	0.73
7.	7,624,692	871,000,000	0.88
8.	6,000,000	504,000,000	1.19
9.	5,669,000	990,000,000	0.57
10.	5,000,000	340,000,000	1.47
11.	4,988,239	189,585,000	2.63
12.	3,393,996	66,855,818	5.08
13.	3,306,250	1,060,000,000	0.31
14.	3,300,000	220,000,000	1.50
15.	3,300,000	231,000,000	1.43
16.	3,125,000	186,000,000	1.68
17.	3,021,000	452,000,000	0.67
18.	2,939,000	618,677,000	0.48
19.	2,781,744	292,476,000	0.95
20.	2,620,921	118,100,000	2.22
21.	2,605,933	454,465,000	0.57
22.	2,579,463	260,000,000	0.99
23.	2,578,274	181,250,000	1.42
24.	2,557,000	570,000,000	0.45
25.	2,531,000	346,000,000	0.73

Mean = 1.32%; Median = 0.99%; Mean all U.S. corporations = 1.1%.

Table 7

Percent of Contributions to Domestic Net Income Before Taxes, 1973
(Companies grouped by size of U.S. assets)

Assets	*Number of Companies*	*Contributions* *Top 10 Percent*	*Top 20 Percent*	*Top 25 Percent*	*Median*
Under $100 million	58	3.16-5.23%[a]	1.65-5.23%	1.50-5.23%	0.86%
$100-200 million	58	3.08-7.22	1.70-7.22	1.60-7.22	0.79
$200-300 million	34	2.98-3.69[b]	2.00-3.69	1.77-3.69	0.91
$300-500 million	39	1.68-2.00	1.30-2.00	1.18-2.00	0.72
$500 million-1 billion	54	1.51-5.08	1.29-5.08	1.11-5.08	0.68
$1-3 billion	88	2.10-4.40	1.51-4.40	1.35-4.40	0.71
$3-5 billion	20	2.82-3.15	1.67-3.15	1.63-3.15	0.88
Over $5 billion	25	1.62-2.71	1.27-2.71	1.20-2.71	0.93
All asset groups	376	2.09-7.22%	1.55-7.22%	1.38-7.22%	0.77%

a. One atypical company in this asset class reported 14.03%.

b. One atypical company in this asset class reported 16.25%.

Table 8

Reasons for Undertaking Contributions Activities
(Responses of 417 chairmen and presidents)

Possible Reasons for Undertaking Contribution Activities	*Specific Activities*[a] *United Funds*	 *Higher Education*	 *The Arts*
Corporate Citizenship: Practice good corporate citizenship.	74%	49%	48%
Business Environment: Protect and improve environment in which to live, work and do business	68	46	43
Employee Benefits: Realize benefits for company employees (normally in areas where company operates).	47	31	31
Public Relations: Realize good public relations value.	34	20	32
Pluralism: Preserve a pluralistic society by maintaining choices between government and private-sector alternatives.	28	40	10
Commitment: Of directors or senior officers to particular causes, involvement.	23	31	28
Pressure: From business peers, or customers and/or suppliers.	12	8	17
Altruism: Practice altruism with little or no direct or indirect company self-interest.	10	8	15
Manpower Supply: Increase the pool of trained manpower *or* untrained manpower *or* access to minority recruiting.	5	63	2
No contributions or activities in this area	2	2	7

a. Adds to more than 100% because multiple responses were requested.

resources. Corporate citizenship and the business environment are also major considerations — as is pluralism. Only with respect to the arts is there no one reason checked by as many as half the respondents.

Pure altruism is not a dominant factor in any of these forms of philanthropy — nor is what may be considered its opposite, "pressure" from one source or another. The less specific reason of good "public relations," however, is considered important by between one fifth and one third of the respondents, varying with the philanthropic field.

Personal Viewpoints

In order to gain greater insight into underlying motivations, chairmen and presidents were asked to express their *personal* points of view as to why their companies *should* or *should not* have a contributions program and other public service activities. The responses to this open-ended question were classified and the results are shown in Table 9.

Table 9

Reasons for Company Public Service Activities
(Responses of 309 chairmen and presidents)

Reason	*Percent*[a]
Social responsibility (good corporate citizenship)	63%
Self-interest (public service necessary for long-range survival)	49
Leadership support (sets the pace, example to others, etc.)	26
Community climate (promote a healthy community in which to live and work)	25
Employee benefits (contributes to personal growth of own employees)	16
Offset government controls	11
Necessary for survival of charitable organizations and programs	6

a. Adds to more than 100% because of multiple responses.

The Pros

Samples of the statements favoring corporate contributions follow:

"A corporation is an integral part of our society and as such it should be a responsible and responsive member of society. By virtue of its role as a producer of products, employer of people, and generator of funds, it has a unique capacity to provide benefits for the public good on a large and pervasive scale. Accordingly, the corporation should utilize its resources to respond to the challenge to improve our society in those areas where it can make a significant contribution."

– Chairman, a major insurance company

"A corporation exists in a community – local, regional, national, even worldwide. It must be concerned with the condition of that community, with the development of the best and broadest possible base of talents, and with the quality of life. The corporate citizen, like the individual citizen, benefits from a healthy community and should encourage efforts to make the community better."

– President, a major communications company

"The corporation operates as part of a greater society. In its operation it can and does recognize areas where help is needed. It should provide that help. It takes a healthy society for corporations to operate; they should contribute to that health."

– President, a machinery manufacturer

"Our free enterprise system, which has contributed so much to the well-being of our people, will continue to grow and prosper only to the extent that it meets the needs and expectations of society. This requires a continuous effort on the part of government, industry and private charities. Industrial corporations need to support private charities so that they can take innovative and practical steps to meet important human problems. Such support on the part of corporations is an essential ingredient of corporate responsibility."

– President, a major insurance company

"Any company has the ability to address itself to public service activities. I believe this is most effectively done by applying the company's capabilities to specific social issues which can benefit from those capabilities. One company can't address all issues, but should concentrate on those where it has expertise."

– Chairman, an electrical machinery manufacturer

"Corporate financial support should be given to organizations that are affected by its operations and that traditionally depend on gifts for financing. 'The corporation' cannot lead – only people can. 'The corporation' should permit and encourage employees to participate in public service activities which are of interest to the employees."

– Chairman, an oil company

"A corporation should return some of its profits to the public through contributions. Also, corporate involvement in public service activities will carry with it sound management practices and expertise that are so often needed by the nonprofit organizations supported."

– President, an electrical machinery manufacturer

"A company, particularly one that is large and diversified, cannot sit back and rely on the outmoded concept that its only objective is profitability. We live in a volatile society that is in flux; our minorities are now sophisticated in the political-legislative area and are vocal and well-organized."

– Chairman, a chemical company

"Our democratic society would be in danger if corporations did not participate in public service activities. In the void that would be created, the government bureaucracy would take over."

– President, an electrical machinery manufacturer

The Cons – and the Maybes

A minority of respondents were more cautious about corporate philanthropy – or opposed it. Some typical views follow:

"The central question relates to the corporation's need to restrict use of stockholders' money to those activities that have a demonstrable relationship to the interests of the business. In areas other than this, contributions are a matter for the individual stockholder."

– Chairman, a major chemical company

"A company has to have some contributions program to maintain a satisfactory posture in the communities in which it is located. . . .Its broad social purpose, however, is to furnish its products and services at competitive prices. In the communities in which it has locations, its purpose is to provide satisfactory and stable employment."

– Chairman, an optical and photographic equipment manufacturer

"There is an undesirable trend to put more and more load on business to come up with solutions to social problems and finance them."

– Chairman, a machinery manufacturer

"We must keep primary the role of making a profit so as to continue operating in order to supply jobs. Without profit, there will be nothing."

– President, a manufacturing company

IV

FACTORS DETERMINING BUDGET LEVELS

In establishing the budget level for expenditures that will be reported to the Internal Revenue Service as charitable contributions, companies use a variety of reference points. Table 10 summarizes the major factors in determining these budget levels, as they are reported by 442 executives responsible for corporate giving.

Table 10

Major Factors in Setting the Level of Dollar Expenditures for Contributions (Responses of 442 officers responsible for corporate giving)

Factor	*Percent*[a]
Based on prior year's contributions	52%
No fixed figure, each contribution assessed separately	44
Based on the amount necessary to achieve philanthropic goals	33
Based on peer company comparisons	29
Percentage of pretax net income	26
Based on industry comparisons	22
Based on average of prior 2-3 years' pretax net income	8
Other	10

a. Adds to more than 100% because of multiple responses.

The most frequent single determining factor in this, as in many budgetary decisions, is last year's budget. Other considerations relating to the company's finances involve pretax net income. Some businesses set the budget as a percentage of pretax net income; a considerably smaller number bases contributions, at least in part, on an average of prior years' pretax net income.

The second and third most frequently mentioned determinants relate not to the firm's finances but to the situation to which it is responding. Forty-four percent set no fixed figure but assess each request separately. And 33 percent of the respondents say their companies give what is necessary to achieve philanthropic goals.

Then there is the question of what others are doing. Twenty-nine percent consider the contributions of companies of comparable size, stature, and philosophy; 22 percent are influenced by others in their industries.

Industry Comparisons

Industrial classification is one of the most widely used yardsticks for comparing contributions (see Table 11). When this approach is used, it becomes apparent that manufacturing firms contribute a higher proportion of pretax net domestic income than do nonmanufacturing firms (0.84 percent as against 0.51 percent). This pattern reflects the number of regulated industries in the nonmanufacturing sector. The low rate for public utilities (0.17 percent) reflects the restrictions of some state regulatory bodies that prohibit including the cost of contributions in the computation of the rate base, as well as high capital and manpower costs.

Table 11

Contributions as a Percent of Domestic Net Income Before Taxes, 1973
(Companies grouped by industry class; insurance companies excluded[a])

Industrial Classification	*Number of Companies*	*Domestic Net Income before Taxes (in thousands)*	*Contributions (in thousands)*	*Percent of Contributions to Net Income before Taxes*	
				All Companies	*Range for Top 25 Percent of Companies*
Chemicals and allied products	35	$ 3,778,660	$ 31,044	0.82%	1.60-6.65%
Electrical machinery and equipment	23	2,934,417	24,998	0.85	1.43-7.22
Fabricated metal products	32	4,798,642	23,090	0.48	0.95-1.96
Food and kindred products	25	1,077,785	9,119	0.85	1.64-5.23
Furniture and fixtures	2	24,926	425	1.71	b
Lumber and wood products	3	380,400	3,894	1.03	b
Machinery, nonelectrical	14	2,296,061	17,245	0.75	1.81-3.07
Paper and like products	18	1,347,807	9,522	0.71	0.95-2.56
Petroleum refining	19	5,605,721	50,788	0.91	1.15-3.15
Primary metal industries	25	2,577,281	23,428	0.91	1.24-3.33
Printing, publishing	8	246,362	8,929	3.62	2.29-2.63[c]
Rubber, miscellaneous plastic products	9	489,790	3,906	0.80	0.92-1.68
Stone, clay and glass products	10	410,383	5,207	1.27	1.27-1.84
Textile mill products	13	372,942	5,635	1.51	2.16-4.13
Tobacco manufacturers	3	579,429	2,544	0.51	b
Transportation equipment	14	1,697,689	21,742	1.28	1.19-2.00
Miscellaneous manufacturing industries	47	2,792,003	22,084	0.79	1.31-4.26
Total: Manufacturing	300	31,389,388	263,800	0.84	–

Table 11 (Continued)

Contributions as a Percent of Domestic Net Income Before Taxes, 1973

Industrial Classification	*Number of Companies*	*Domestic Net Income before Taxes (in thousands)*	*Contributions (in thousands)*	*Percent of Contributions to Net Income before Taxes*	
				All Companies	*Range for Top 25 Percent of Companies*
Banking	30	2,026,383	24,677	1.22	1.64-4.40
Diversified financial	5	208,008	908	0.44	b
Public utilities	22	7,931,619	13,123	0.17	0.47-2.49
Retailing	12	1,902,892	19,735	1.04	1.33-3.79
Transportation	11	658,657	6,208	0.94	1.29-2.20
Other nonmanufacturing	5	365,573	2,197	0.60	b
Total: Nonmanufacturing	94	13,093,142	66,848	0.51	–
Total: All companies	394	$44,482,530	$330,848	0.74%	–

a. Insurance company figures are based on "net gain from operations after dividends to policyholders and before federal income tax, excluding capital gains and losses" – the closest measure to pretax net income of corporations generally. On this basis, data for 28 insurance companies showed: Total net gain from operations: $2,132,349,000. Total contributions: $17,729,000. Contributions percent: 0.83%. Range for top 25% of insurance companies: 1.22-3.60%.

b. Classifications with less than 8 companies omitted.

c. Eliminating one atypical company contributing 16.25%.

Because of the very small samples for several industries, the data in Table 11 should be interpreted with great care. This is particularly true for the printing and publishing industry, where one company channeled an atypical 16.25 percent of pretax income to philanthropy through its foundation. Among the nonmanufacturers, the banking group was the leader as it had been in 1972.

Insurance company data are excluded from the calculations in the table, but they are shown in a footnote. The closest measure to pretax net income of corporations for this industry is "net gain from operations after dividends to policyholders and before federal income tax, excluding capital gains and losses." On this basis, 28 insurance companies showed contributions averaging 0.83 percent of net gain from operations before taxes.

A more detailed analysis of the contribution rates of the top 10,20, and 25 percent of companies in each industry classification is presented in Table 12. For additional tables on contributions as a percent of net income before taxes see Tables 1, 6, and 7.

Recipient of the Corporate Dollar

This study did not include the collection of data on the distribution of contributions among the several categories of beneficiaries. Table 13 is reproduced from the 1972 survey, based on a similar population, as an indication of how the funds are distributed.

V

PUBLIC SERVICE ACTIVITIES

In addition to the estimated $1.25 billion contributed to various philanthropies and reported to the Internal Revenue Service as charitable contributions, corporations spend up to an additional $1 billion a year, reported as business expenses or representing other social costs to business (for example, low interest loans for social purposes) on public service activities. Beyond that, nearly half a billion dollars is also raised annually by fund-raising drives companies conduct among their employees for United Way programs. A great diversity and depth of corporate involvement in such activities is characteristic of "leading edge" companies.

Costs

Corporate contributions reported to the IRS as charitable ($1.25 billion annually) is the only component of public service activities for which national statistics are available. Under present reporting conditions, it would be impractical to assemble cost figures for other public service activities on a national basis. Although these costs are obviously considerable, this Conference Board study indicates that very few companies have gathered and published these data because of the difficulties and costs of doing so. For example, if the cost per company were $25,000, the cost of assembling and publishing such data for the *Fortune* list of 1,300 would be $32.5 million; if the cost per company were $50,000, the task would require $65 million. As a consequence most corporations do not know the *total costs* of their own philanthropic activities.

Because national data are not available on the costs of these programs, respondents were asked to make rough estimates of the costs of public service activities, using their charitable contributions as the basis for comparison.

Table 12

Contributions by Leading Donors as a Percent of Domestic Net Income Before Taxes, 1973
(Companies grouped by industry class)

Industrial Classification	*Number of Companies in Sample*	*Grouping by Contributions* *Top 10 Percent*	*Top 20 Percent*	*Top 25 Percent*	*Median*
Chemicals and allied products	35	3.68-6.65%	1.88-6.65%	1.60-6.65%	0.69%
Electrical machinery and equipment	22	4.62-7.22	1.56-7.22	1.43-7.22	0.75
Fabricated metal products	31	1.53-1.96	1.19-1.96	0.95-1.96	0.70
Food and kindred products	23	4.46-5.23[c]	1.85-5.23	1.64-5.23	1.14
Machinery, nonelectrical	14	2.54-3.07	2.00-3.07	1.81-3.07	1.35
Paper and like products	18	2.02-2.58	1.10-2.58	0.95-2.58	0.67
Petroleum refining	19	1.68-3.15	1.42-3.15	1.15-3.15	0.50
Primary metal industries	25	2.41-3.33	1.42-3.33	1.24-3.33	0.72
Textile mill products	13	3.66-4.13	2.55-4.13	2.16-4.13	1.50
Transportation equipment	13	1.85-2.00	1.32-2.00	1.19-2.00	0.66
Miscellaneous manufacturing	45	1.74-4.26	1.40-4.26	1.31-4.26	0.71
Banking	39	2.71-4.40	1.90-4.40	1.64-4.40	1.21
Insurance[a]	28	2.10-3.60	1.32-3.60	1.22-3.60	0.69
Public utilities	22	1.21-2.49	0.57-2.49	0.47-2.49	0.31
Retailing	11	3.64-3.79	2.36-3.79	1.33-3.79	1.07
Industrial Classification (10 or less companies per class)[b]					
Printing and publishing	8			2.29-2.83[d]	0.96
Rubber and miscellaneous plastic products	9			0.92-1.68	0.83
Stone, clay and glass products	10			1.27-1.84	0.73
Transportation companies	9			1.29-2.20	0.45

a. For insurance companies, percent of contributions to net gain from operations after dividends to policyholders and before taxes is the measure used.

b. Detailed groupings omitted for classifications with fewer than 8 companies.

c. One atypical company in this classification reported 14.03%.

d. One atypical company in this classification reported 16.25%.

Table 13

The Company Contributions Dollar, 1972

	443 Companies	
	Thousands of Dollars	*Percent of Total*
Health and welfare		
Federated drives: United Funds and the like	$ 85,951	26.65%
National health agencies (not included above)	3,304	1.02
National welfare agencies (not included above)	5,935	1.84
Hospitals		
Capital grants	15,974	4.95
Operating grants	1,919	.59
Other local health and welfare agencies	14,392	4.46
Capital grants (excluding hospitals)	8,037	2.49
Total health and welfare	135,514	42.01
Education		
Higher education		
Scholarships	13,837	4.29
Fellowships	4,559	1.41
Research grants (not treated as a business expense)	8,102	2.51
Capital funds	17,740	5.50
Direct unrestricted grants	37,299	11.56
Grants to state, area and national fund-raising groups	8,497	2.63
Education-related agencies	3,151	.98
Other	15,341	4.76
Secondary education		
Capital grants	645	.20
Other	7,700	2.39
Total education	116,876	36.23
Culture (cultural centers, performing arts, museums, etc.)		
Operating funds	10,462	3.24
Capital grants	2,729	.85
Total cultural	13,192	4.09
Civic causes (municipal and community improvement, good government, and the like)		
Total civic	29,487	9.14
Other		
Religious causes	1,293	.40
Groups devoted solely to economic education	2,318	.72
Groups in United States whose principal objective is aid to other countries	3,418	1.06
Causes other than above	16,604	5.15
Total "other"	23,634	7.33
Dollars not identifiable because donee is unknown	3,859	1.20
Grand Total	$322,564	100.00%

Source: Table 1, Conference Board Report No. 606, 1973.

- The largest number of companies (297 or 71 percent of those answering this question) said they could not make even rough estimates.

- Sixty companies (14 percent) estimate that public service activities cost one half the amount they contribute to charity.

- Fifty-one companies (12 percent) estimate that they spend more on public service activities than on charitable contributions.

- Thirteen companies (3 percent) estimate that they spend equal amounts on the two categories of activities.

The Business Committee for the Arts, Inc., (BCA) commissioned the most extensive study that has been able to document a ratio between charitable contributions and business expenses that benefit charitable institutions. This BCA study which was limited to the arts, estimates that corporations contributed $144 million to the arts in 1973. Of this amount, one dollar was given as business expense for every dollar given as a charitable contribution.

No comparable national data are available for health, welfare, education, or other areas of corporate involvement. Therefore, it is not known if this dollar for dollar ratio is maintained in those areas as it is in the arts. Such data as are available, however, would suggest that business expenses for charitable purposes might well be up to an additional 80 percent ($1 billion) of the dollars contributed as charitable contributions ($1.25 billion). A number of contributions executives believe that business expenses to a corporation could be much more than $1 billion, but doubt that corporations will be willing to take the time and effort necessary to document these costs.

Administration

There is general agreement among contributions executives that costs of administering a contributions program may total up to an additional 10 percent to 15 percent of the contributions budget. Based on $1.25 billion of company charitable contributions, administrative costs would total $125 million and $187.5 million respectively.

This amount does not include administrative costs of urban affairs and community affairs programs. In some companies the number of staff members in these two areas is as large as or larger than contributions staff.

Company Facilities

Many companies make their facilities available without charge for various charitable purposes, but very few keep dollar figures on the costs – only 22 companies supplied figures in this survey. The overall total was $840,000. The lowest figure reported was $1,000, the highest was $385,000, with a median of $10,000. Ten of the 22 companies supplying data were banks or insurance companies; the remainder were scattered in a number of industries.

Miscellaneous Cost Data

Only 58 companies (13 percent) report that they have calculated the financial cost of employee involvement in at least one corporate public service activity, but not all of these companies supplied specific data. Twenty-eight companies did give figures on business expenses exclusive of contributions. The total cost of these was $4 million. The range was from $1,000 to $2.1 million, with a median of $22,500.

Ten companies supplied cost figures for a variety of other public service activities, including a day-care center, a retired employees community service program, an internship program, and deposits in minority banks. The costs range from $1,000 to $3,000,000, and show no particular industry pattern.

Only a few corporations could determine the total cost of donated time of employees who work with charitable institutions while the company continues to pay their salaries. Such a determination would have to include time spent by

- loaned employees (in 41 percent of the companies surveyed) who worked on a full-time basis with charitable organizations

- loaned employees (in 73 percent of the companies surveyed) who worked on a part-time basis with charitable organizations

- employees (in 13 percent of the companies) who were granted leaves of absence to assist charitable institutions, including teaching assignments at colleges and universities.

Only 40 companies had calculated the donated time of employees, and this was normally limited to one volunteer activity, rather than including the whole range of volunteer activities. The aggregate cost to these 40 companies was $3 million. The lowest figure was $1,000, the highest was $625,000, and the median was $39,000.

In 94 percent of the companies, employees were encouraged to take part in public service activities on their own time. In 78 percent, employees were encouraged to volunteer for public service activities on company time.

The variety of participation and the associated costs would have to include time spent by

- a company's chairman or president (6.8 hours a week – of which half is on company time)

- part-time employee involvement with United Fund organizations, which may involve up to 10 percent of the total employee population in each company, a percentage recommended by United Fund organizations in conducting fund-raising drives

- employee involvement with thousands of charitable organizations at all levels.

Areas of Corporate Involvement

The broad range of philanthropic activities in which corporations participate is suggested by the list located at the end of this chapter. Although all of these areas benefit from corporate charitable contributions, most of them also benefit from business expenses – including financial contributions and skilled manpower.

Activities in some areas (employment and training; civil rights and equal opportunity) are heavily weighted toward business expenses and manpower involvement, with modest grants of a philanthropic nature. Some areas involve both voluntary and mandated activity. Activities currently of a voluntary nature are described below.

United Way

There is widespread support for United Way (also called United Fund) activities at every employee level in corporations. As was indicated earlier, one out of every two chairmen or presidents is active in a United Fund as a board or committee member, and considers it one of his most important philanthropic associations. Up to 10 percent of company employees are actively involved annually in soliciting for local campaigns.

In 1973, the United Way organizations raised approximately $975 million. Approximately $277 million (28 percent) came from corporations; $450 million (46 percent) from individual employees and executives of corporations; and others gave $248 million (25 percent).

The extent of corporate involvement is not surprising. Businessmen have been instrumental in establishing United Funds to bring professionalism and coordination to fund raising to replace splintered fund-raising activities. A coordinated fund-raising approach can lead to efficiency and effectiveness with the setting of standards and an accrediting program.

United Funds received a company contribution from 99 percent of the companies in this study in 1973, and there was a solicitation of personal contributions from employees in 97 percent of the companies. Moreover, 79 percent of the corporations loaned employees to United Funds to assist in their fund-raising campaigns, in addition to using company employees to solicit fellow employees.

Blood Banking

Blood banking is another area in which industry has made significant but unmeasured contributions by encouraging employee blood donations and providing the mechanisms for them.

Blood storage has been a key to modern surgery and other forms of lifesaving therapy for a generation. From the start, the nation's blood banks have regarded places of employment as major and indispensable sources of supply. As a recent Conference Board report noted, such work places have attributes that, taken together, are unique and potentially powerful. "They can provide the blood-banking system with access to large numbers of people who are within the donation-eligible age range" in a setting that "offers favorable conditions for education and persuasion" and that "minimizes donor effort, inconvenience and time."[5]

But the potential of the workplace is realized only to the extent that business management takes certain organizational steps and assumes certain costs – principally the salaries and wages paid for time spent by employees in organizing blood drives and in making blood donations.

The cost of this kind of contribution to the company is modest relative to a considerable social gain. The portion of the nation's blood resources accounted for by employee contributions is not known, but the American National Red Cross has identified "plants and firms" as the source of at least 28 percent of the blood collected by its network of 59 regional centers – and Red Cross officials believe the true figure to be still higher. In New York City, two thirds of the blood collected by the Community Blood Center of Greater New York comes from corporate employees. The use of commercially collected blood frequently leads to the transmission of major diseases, such as hepatitis, at a heavy cost to the individual and the health system. Increased use of voluntary blood donors serves a real social need and acts as a preventive health measure.

Coordinated Business Approaches: Economic Development Council of New York City

In recent years, the trend has been toward involving the business community more and more in urban issues and public administration. A most striking current example is, of course, business' help in the management of New York City's fiscal crisis. But, even prior to the current crisis, one of the most ambitious plans in the nation was being operated in New York City by the Economic Development Council (EDC).

EDC is one model of how to bring the capabilities of the business community to bear on vital urban problems. EDC business assistance task forces, composed of "on loan" managerial personnel, work to improve the organization and operation of major city government agencies. Managerial specialists on full-time loan from their companies have used their skills to improve governmental services to the public while actually reducing the costs.

EDC business assistance task forces have worked in three major areas of government – the administration of justice, the operation of welfare and social services, and the business management of the public school system. Currently, a twelve-executive task force is focusing specifically on problems of middle-income housing projects. Task forces concentrate on problems of organization and administration, and focus on changes which can be implemented readily by administrative (rather than legislative) action.

EDC has tried to document the "cost of voluntarism" as well as the actual savings to government agencies. In January 1973, EDC adopted a policy of costing out the contributed services of loaned executives, and a value for such services has been reflected both as income and as expense in the balance sheets which have been audited by Price Waterhouse & Co. Since 1969, some 104 person-years of executive time, valued at $2.6 million, have been contributed to the EDC task force program by New York companies at no cost to the city. Actual annual budgetary savings of $78 million a year, plus a one-time saving of $48.5 million, have so far been recorded as a result of their various activities. EDC estimates that potential additional savings, as a result of the reorganizations, could reach $676 million a year.

National Alliance of Businessmen

Another example of public service activity not reflected in charitable contributions dollars is the service rendered by the National Alliance of Businessmen. Formed in 1968 after the outbreak of urban riots in the previous year, the NAB objective was to find jobs for the disadvantaged in the private sector. The figures are impressive: From the end of 1968 to mid-1975, nearly 4 million persons have been placed as a result of NAB efforts, which included both corporate and governmental expenditures:

- 1,952,942 disadvantaged
- 1,191,155 young people (disadvantaged high school and college students in the Summer Youth Program, operating since 1970)
- 720,000 Vietnam veterans (since 1971)
- More than 20,000 ex-offenders (since 1974)

Ten Areas That Receive Corporate Support[4]

Education:

- direct financial aid to schools, including scholarships, grants and tuition refunds
- support for increases in school budgets
- donation of equipment and skilled personnel

- assistance in curriculum development
- aid in counseling and remedial education
- establishment of new schools, running schools and school systems
- assistance in the management and financing of colleges

Culture and the Arts:

- direct financial support to art institutions and the performing arts
- development of indirect support as a business expense through gifts-in-kind, sponsoring artistic talent, and advertising
- participation on boards to give advice on legal, labor and financial management problems

Government:

- helping to improve management performance at all levels of government
- supporting adequate compensation and development programs for government executives and employees
- working for the modernization of the nation's governmental structure
- facilitating the reorganization of government to improve its responsiveness and performance
- advocating and supporting reforms in the election system and the legislative process
- designing programs to enhance the effectiveness of the civil services
- promoting reforms in the public welfare system, law enforcement, and other major governmental operations

Medical care:

- helping plan community health activities
- designing and operating low-cost medical-care programs
- designing and running new hospitals, clinics and extended-care facilities
- improving the administration and effectiveness of medical care
- developing better systems for medical education, nurses' training
- developing and supporting a better national system of health care

Civil Rights and Equal Opportunity:

- ensuring employment and advancement opportunities for minorities
- facilitating equality of results by continued training and other special programs
- supporting and aiding the improvement of Black educational facilities and special programs for Blacks and other minorities in integrated institutions
- encouraging adoption of open-housing ordinances
- building plants and sales offices in the ghettos

- providing financing and managerial assistance to minority enterprises; participating with minorities in joint ventures

Urban Renewal and Development:

- leadership and financial support for city and regional planning and development
- building or improving low-income housing
- building shopping centers, new communities, new cities
- improving transportation systems

Employment and Training:

- active recruitment of the disadvantaged
- special functional training, remedial education, and counseling
- provision of day-care centers for children of working mothers
- improvement of work and career opportunities
- retraining of workers affected by automation or other causes of joblessness
- establishment of company programs to remove the hazards of old age and sickness
- supporting, where needed and appropriate, the extension of government accident, unemployment, health and retirement systems

Conservation and Recreation:

- augmenting the supply of replenishable resources, such as trees, with more productive species
- preserving animal life and the ecology of forests and comparable areas
- providing recreational and aesthetic facilities for public use
- restoring aesthetically depleted properties such as strip mines
- improving the yield of scarce materials and recycling to conserve the supply

Pollution Abatement:

- installation of modern equipment
- engineering new facilities for minimum environmental effects
- research and technological development
- cooperating with municipalities in joint treatment facilities
- cooperating with local, state, regional and federal agencies in developing improved systems of environmental management
- developing more effective programs for recycling and reusing disposable materials

Economic Growth and Efficiency:

- increasing productivity in the private sector of the economy

- improving the innovativeness and performance of business management
- enhancing competition
- cooperating with the government in developing more effective measures to control inflation and achieve high levels of employment
- supporting fiscal and monetary policies for steady economic growth
- helping with the post-Vietnam conversion of the economy

Communications

The significant involvement of corporations in public service activities and actual philanthropic contributions is not widely known or understood. However, a growing number of companies are already including a special section on such activities in their Annual Reports; some are issuing special reports on contributions and other public service activities. It is believed that such communication leads to better understanding of the corporation by shareholders, employees, customers, recipients of the contributions, and the communities in which the company operates.

Only a small number of company foundations produce reports and make them available to the general public. Of 1,000 company foundations, fewer than 50 publish foundation reports.

VI

COMPANY FOUNDATIONS, TAXES, AND THE TAX REFORM ACT OF 1969

As a private foundation, the company foundation is subject to the provisions of the Tax Reform Act of 1969 (TRA). It has been observed that this legislation has made gifts through company foundations less attractive as an alternative to direct corporate contributions.[6] A company foundation makes it possible, among other things, to divorce contributions from possible fluctuations in company earnings — to avoid the peaks and valleys — and to maintain the same level of giving in periods of reduced business activity when needs of charitable organizations are usually greater.

The percentage of corporate contributions that comes from company foundations — as opposed to direct corporate giving — has decreased in the last few years. In 1973, 41 percent of the $350 million given by 424 companies came from company foundations. In 1974, only 35 percent of the $438 million given by 799 companies came from grants by company foundations. This decline in foundation activity may reflect continuing impact of the Tax Reform Act of 1969.

Tax incentives are among the major factors in corporate giving. However, they are not the only determinants: Profits and philosophy are the other two linchpins. Similarly, tax incentives are not the only reasons for company foundations. In the 1973 Conference Board study of the effects of the 1969 act, many respondents noted that the formation and use of company foundations led to more professionally managed programs.

Effects on Existence of Company Foundations

The first approach to the impact of the TRA on company foundations has to do with the very existence of such institutions. Four hundred and twenty-three executives responsible for corporate giving answered the question, "Did you dissolve or inactivate your company foundations because of the impact of the Tax Reform Act of 1969?" The responses were

	Number of Companies	*Percent*
Yes	29	7%
No	219	52
Does not apply	175	41
Total	423	100

The complementary question, "If your corporation was planning to form a foundation, did you abandon such plans because of the impact of the Tax Reform Act of 1969?" was answered by 377 executives in this fashion:

	Number of Companies	*Percent*
Yes	10	3%
No	24	6
Does not apply	343	91
Total	377	100

The negative impact on 10 percent of existing or planned foundations is consistent with the findings of the previously cited Conference Board study of the impact of the act. That 1973 study found that 24 of 240 company foundations either had been terminated or were in the process of being phased out.

Effects of Specific Provisions

Table 14 summarizes the responses on the subject of specific provisions of the TRA that create difficulties for the corporations in this survey. The 4 percent excise tax on foundation net investment income was mentioned most often (29 percent included it among their responses). This tax reduces the funds that would otherwise be available for a foundation's program. In effect, it penalizes potential recipients. The 4 percent tax is the only such levy on hitherto tax-exempt organizations.

Restrictions on gifts-in-kind and gifts of appreciated property are the next most frequently mentioned difficulties. Prior to 1969, business corporations making charitable gifts-in-kind in the form of property they had created (also known as inventory donations) were allowed a tax deduction on the basis of the fair market value of such property. The 1969 legislation altered the valuation basis of such gifts to cost. More than 3 out of 10 corporate leaders say they would increase charitable donations if gifts of inventory were deductible at fair market value instead of at cost. The significance of this consideration appears to vary from industry to industry (see Table 15). Again, the very small samples for some industries make interpretations of these data difficult.

Both this study and the earlier Conference Board report on the impact of TRA indicate that a considerable majority of company foundations are managing to cope with this legislation – although it does have a depressing influence overall. This raises the question of the possible effect of other changes in the tax structure – including some designed to encourage such philanthropy.

Table 14

Effect of Provisions of the Tax Reform Act of 1969 on Company Foundations
(Responses of 336 executives responsible for corporate giving)

Provision	*Percent Considering Provision a Source of Difficulty*[a]
4 percent excise tax on foundation net investment income	29%
Restrictions on gifts-in-kind	21
Restrictions on gifts of appreciated property	20
Requirements on minimum distribution	6
Restrictions on self-dealing transactions	5
Requirements on foundation holdings of company stock	4
Restrictions on expenditures for lobbying, campaigning, and awards and grants	4
Other	5
Clerical procedures	4
Does not apply	41

a. Percentages exceed 100% because of multiple responses.

Potential Effects of Alternative Tax Changes

The chairmen and presidents who responded to this survey were asked to consider the potential effects of a series of tax changes on their companies' contributions. The results are summarized in Table 16.

Increasing deductibility beyond 100 percent and a tax credit appear to be the most powerful incentives among tax changes that have been discussed. Reestablishing the deductibility of gifts-in-kind at fair market value, instead of cost, has more limited appeal – possibly because of its varying significance for different industrial groups. In that same connection, the tax credit was particularly favored by the insurance industry because of the special tax situation under which it operates. The head of a major insurance company said:

> Under the present federal tax formula for life insurance companies, most large companies obtain no effective tax deduction for their charitable contributions. This is so because these companies pay a tax grounded in taxable investment income under Section 804 (Phase I). The charitable deduction, however, is only recognized in the computation of gain or loss from operations under Section 809 of the Code (Phase II). A tax credit would rectify this anomalous situation. Alternatively, a specific deduction for charitable contributions in the computation of taxable investment income under Section 804 would serve to give an effective tax deduction to all companies.

Establishing a contributions *floor* (specifying a minimum percentage of contributions to net income before taxes) that would have to be met before the total of all contributions would be deductible would have a depressing effect on charitable donations. And, as the table shows, the higher the floor, the greater the deterrent effect.

The present requirement that limits deductible contributions to 5 percent of taxable income has had virtually no effect on the level of contributions of *major*

Table 15

Anticipated Effects of Reestablishing Deductibility of Gifts of Inventory at Fair Market Value (By industry classification; insurance companies excluded)

Industry Classification	*Number Responding*	*Increase*	*No Change*	*Reduce*
		Percent	*Percent*	*Percent*
Manufacturing	274	41%	58%	1%
Chemicals and allied products	32	72	28	0
Electrical machinery and equipment	19	47	53	0
Fabricated metal products	33	39	61	0
Food and kindred products	21	52	48	0
Furniture and fixtures	2	100	0	0
Lumber and wood products	3	67	33	0
Nonelectrical machinery	14	43	50	7
Paper and like products	16	38	63	0
Petroleum refining	17	12	88	0
Primary metal industries	22	23	77	0
Printing, publishing	9	33	56	11
Rubber and miscellaneous plastic products	9	44	56	0
Stone, clay and glass products	7	29	71	0
Textile mill products	12	33	67	0
Tobacco manufacturers	4	50	50	0
Transportation equipment	9	11	89	0
Miscellaneous manufacturing	45	40	58	2
Nonmanufacturing	85	18	81	2
Banking	35	14	83	3
Diversified financial	5	20	80	0
Public utilities	22	9	91	0
Retailing	11	55	46	0
Transportation companies	7	0	100	0
Other nonmanufacturing	5	40	60	0
Total Companies	359	35%	64%	1%

corporations. Commenting on the effect of this limitation, 43[illegible] executives responsible for corporate giving responded in this way:

	Percent
Negative effect	7%
Positive effect	2
No effect	86
Does not apply	5

Although there are very few *major* corporations at the 5 percent level, as has already been noted, 51,000 smaller companies may be affected by the limitation.

Table 16

Potential Effects of Alternative Tax Changes on Company's Contributions
(Responses of 417 chairmen and presidents)

Alternatives	*Increase*	*No Effect (or Stay the Same)*	*Reduce*	*Eliminate Program*	*No Answer*
	Percent	*Percent*	*Percent*	*Percent*	*Percent*
Allowing more than 100 percent of contributions as a deductible expense.	48%	47%	–	–	5%
Providing a tax credit that would result in a lower "after-tax cost" than the present 100 percent deductibility.	49	42	4	–	5
Establishing a contributions floor (specified minimum percentage of contributions to net income before taxes) that would have to be met before the total of all contributions would be deductible:					
1 percent minimum floor of contributions to net income before taxes.	12	50	24	6	8
2 percent minimum floor of contributions to net income before taxes.	17	28	31	12	12
Reestablishing deductibility of gifts of inventory at fair market value instead of at cost.	32	59	1	–	8

Other Factors Affecting Contributions

Increased tax incentives are undoubtedly the most important single factor in increasing contributions. However, chairmen and presidents would consider increasing their companies' contributions (as percentage of net pretax income) by 50 percent or more over a two- to five-year period if other conditions – including stockholder approval of increases – prevailed (see Table 17).

Table 17

Conditions for Increasing Company's Percentage of Contributions to Taxable Income by 50 Percent or More over a 2 to 5 Year Period
(Responses of 408 chairmen and presidents)

Condition	*Percent*[a]
If tax incentives were increased	53%
If I thought stockholders approved increased contributions	24
If I had more confidence that our contributions program is successful	23
If peer companies would increase their percentage	21
If my industry as a whole would increase its percentage	10
If earnings and profits increased	7
Depends on ability to give	6
If need for our support were justified	2

a. Exceeds 100% because of multiple responses.

The special tax situation of the insurance industry has already been discussed. Public utilities also face a special situation, as do transportation services. The chief executive officer of one utility replied: "Our contributions policy is governed more by the extent to which the Public Service Commission will approve the contribution than by any other factor."

The response of almost one quarter of these executives that donations would increase "if I had more confidence that our contributions program is successful" is intriguing. On the one hand, the question of accomplishment and how it should be evaluated is fundamental to all types of philanthropy. On the other hand, the question of how to evaluate effectiveness may well be one that plagues management with respect to all its non-profit-making activities.[7]

Charitable Deductions and Business Expenses

A majority of the responding executives (59 percent) responsible for corporate contributions regard the 100 percent deductibility as a tax incentive; the remainder – a substantial minority – do not. Of those who consider deductibility as a tax incentive, one third noted that charitable contributions are not interchangeable with business expenses and cannot always be deducted as such. The spokesperson for one leading oil company elaborated on this:

> An eligible charitable expenditure cannot be deducted as a charitable deduction *or* a business expense. Section 162 of the Internal Revenue Code provides for the deductibility of trade or business expenses and further provides in subsection (b) that no deductions shall be allowed as a trade or business expense for any contribution or gift which would be allowable as a

charitable deduction were it not for the percentage limitations and other limitations applicable to charitable contributions. The position of the Internal Revenue Service. . .is that an expenditure will be classified as a charitable contribution if the payment is completely gratuitous and will be classified as a trade or business expense if it bears a direct relationship to the taxpayer's business and is made with a reasonable expectation of a financial return commensurate with the amount of the expenditure.

Shown below are categories of reasons for thinking the 100 percent deductibility provision is or is not an incentive:

The Present 100 Percent Charitable Deductibility Provision Viewed as a Tax Incentive

165 executives responsible for corporate giving believe it is an incentive because:

	Percent Mentioning[a]
All are not necessarily deductible as business expenses	33
Assures tax deductions for contributions	19
Nondeductibility would be a brake on giving	18
Easier to administer as charitable contribution than business expense	8
Encourages formation of company foundation	3
Other	20

112 executives believe it is not an incentive because:

	Percent Mentioning
No reason given	38
Contributions not based on tax incentives	36
5 percent limitation	8
Other	19

[a] Do not add to 100% because of rounding.

Sample statements from those who believe the 100 percent deductibility provision is an incentive include this one from the assistant treasurer of a major automobile firm:

"Deductibility is not an incentive or a disincentive. However, if deductions were not allowed for charitable giving, they would be the only corporate expenditures so treated. As such, this would be a tax penalty indicating that charitable giving by corporations was against public policy (which is not now true)."

And the spokesperson for an electrical machinery company put it this way:

"Operating philosophy plus ability to pay provide incentive to give – not tax deductibility (but a lack of, or reduction in, tax deductibility would be a disincentive to giving)."

A major company involved in government contracts made a special point:

"Charitable contributions are not allowable for pricing purposes under government contracts. Therefore, tax deductibility is a factor in determining the amount of contribution."

Among those who believe that the deductibility provision is not an incentive are those who say that it makes no difference because a charitable contribution can be treated as either a deduction or a business expense. (This is clearly a different view of the Internal Revenue Code than that quoted above.) This comment is from a major oil company:

"Contributions are made because of the corporation's desire to participate in solving problems. The fact that there is a tax advantage in giving is of secondary importance. It costs more dollars to give than not to give – after tax or by any other criterion."

Highlighting the utilities' special problem is this statement:

"As a utility our charitable contributions are treated as business expenses for rate-making purposes, and thus the two methods become indistinguishable. There are no tax incentives involved, in our judgment."

Charitable Contribution or Business Expense?

Financial contributions and gifts of property are overwhelmingly reported as charitable deductions. According to 431 executives responsible for corporate giving:

- 89 percent report them primarily as charitable deductions
- 3 percent report them primarily as business expenses
- 7 percent report them in both categories
- The remainder make no contributions

The reasons for reporting primarily as charitable deductions or as business expenses are summarized in Table 18. Unsurprisingly, the major reason is how the corporation considers the expenditure.

Table 18

Reasons for Choosing Method of Reporting Contributions

	Percent[a]
Primarily as Charitable Deduction	*89%*
Considered more as charitable than business expense	59
For simplicity of administration due to IRS classification	48
Required under regulations	4
Funding of corporate foundation	1
Primarily as Business Expense	*3*
Considered more a cost of doing business than a charitable donation	53
Discretionary grants made for business reasons, many times at the local level	13
Other	27

[a] Do not add to 100% because of multiple responses.

The tabulation below shows the responses of those companies that report in both categories. Here, again, the donor's perception appears to be the major guideline:

	Percent
Do you have guidelines for determining which contributions are business expenses and which are charitable deductions?	
Yes	68
No	32
Are distinctions clear and clean cut?	
Yes	73
No	27
Are guidelines in written form?	
Yes	43
No	57
How are determinations made? (multiple responses)	
By recipient organization being classified as closer to business-related interests than charitable interests	60
By purpose of grant being closer to business-related interests than charitable interests	58
Other	14

VII

MANAGEMENT AND STAFFING

A number of leading corporations have been examining their financial contributions and other public service activities to make certain they receive the same quality of management attention that other corporate functions receive, with carefully thought-out policies, goals and objectives characteristic of well-managed activities. These corporations are being more thoughtful about their rationales for social responsibility activities. Goals and objectives are being defined in the contributions and other public service areas as they are in the production and selling of goods and services.

The earmarks of a well-managed social responsibility program include clearly defined policy, goals and objectives; budgeting for contributions and public service activities; well-organized screening and administrative procedures; and application of performance standards to new and ongoing grants. Effective management might entail full-time or part-time staff and the use of outside consultants and organizations.

The organization of corporate public service activities, including contributions, must be tailored to the size and character of the corporation. Some corporations find it effective to organize on a broad basis, using a total resource approach which coordinates management of contributions, urban affairs, community affairs, voluntarism, individual senior management efforts, loans at lower-than-market rates, and any other pertinent activities undertaken by the company. Other corporations find it appropriate to structure such activity on a narrower basis with limited staff attention.

In either type of organization, it is important that the top corporate leadership have good staff work and receive appropriate analyses on public service activities in which they are engaged. Management personnel slated to move into top leadership positions might also be involved so that they will be cognizant of their responsibilities as they move up the corporate ladder.

Unfortunately, the earmarks of a well-managed program are not characteristic of most programs examined for this study. A random sample of 50 companies revealed that fewer than 10 percent had such characteristics.

Contributions and Foundation Staff

Fifty-five percent of the companies surveyed had less than the equivalent of one full-time professional person working on contributions. Only one out of four companies had one full-time professional working in this area. One out of 5 companies had more than one professional staff person; the largest staff was 20 people. Table 19 shows the size of professional and supporting staffs.

Table 19

Number of Staff Members – Charitable Contributions and/or Foundation Activities

Number on Staff	*Full-Time[a] Professional Staff*	*Full-Time[a] Clerical Staff*
	Percent[b]	*Percent*
Less than 1	55%	58%
1	26	27
2	7	9
3	6	3
4	3	1
5-10	3	2
Over 10	1	*

a. 410 executives responsible for corporate giving provided data on professionals; 405 on clerical staff.

b. Do not add to 100% because of rounding.

*Less than 0.5%.

Table 19 should be interpreted carefully. In addition to the contributions personnel, other company employees usually participate in various aspects of the contributions program. This includes an urban affairs or community affairs staff (usually as large or larger than the contributions staff), plus members of a contributions committee, and the services on an occasional basis of company experts to deal with special programs in the fields of medicine, engineering, and other areas. In 77 percent of the companies, contributions committees are responsible for overseeing contributions activities. Ninety-nine percent of the companies made contributions, and 93 percent have a formal program with budgets. The officer responsible for corporate giving is most commonly a vice-president (45 percent of the responses), but responsibility for the function is placed under any of a number of corporate officers.

Accountability and Evaluation

A few corporations are beginning to utilize evaluation techniques more fully to measure the effectiveness of their public service activities, new and ongoing grants, as well as the performance of donee organizations. Corporate accountability entails responsibility to be sure the money is well spent, and a number of corporations are measuring their performance in their social responsibility programs.

Some corporations are beginning to insist upon accountability from the donee. They are asking donees to identify their objectives clearly; to define the use they want to make of corporate resources; to set up standards to measure their own performance. They appear to want consistent, thorough information from donee organizations. As a minimum requirement, annual audit reports, prepared by an independent certified public accountant, need to be readily available and routinely submitted with requests for assistance. Greater accountability and documentation by donees as to their performance are needed to instill corporate confidence.

It was noted earlier that there is a question in the minds of some chairmen and presidents about the effectiveness of the corporate programs. Part of the problem may lie in the matter of definitions of goals and policies, quality of personnel – in a word, professionalism.

The top corporate officers are more likely to be involved in setting goals and budget levels – even setting priorities – than in determining the size or validity of specific contributions (see Table 20). This may leave a gap in the very area where clues to effectiveness might be found.

Table 20

Role Played by Chairmen and Presidents in Corporations' Contributions Programs
(405 responses)

Activity	*Major Role*	*Moderate Role*	*Minor Role*	*No Role*
	Percent	*Percent*	*Percent*	*Percent*
Setting goals	74%	20%	3%	3%
Setting priorities	61	31	6	2
Setting budget levels	69	24	4	3
Determining specific contributions	31	39	23	7

The techniques used by corporate contributions and foundation staffs to evaluate new and ongoing grants are summarized in Table 21. Several companies specifically mentioned using committee analysis, employee participation in the activities of the potential recipient, and evaluating agencies (such as the National Information Bureau and the Council of Better Business Bureaus) for judging recipient organizations.

VIII

RECOMMENDATIONS OF THE BUSINESS ADVISORY COMMITTEE

The Commission on Private Philanthropy and Public Needs received assistance and guidance from approximately 120 official consultants and advisers. Eleven

Table 21

Procedures Used by Contributions and/or Foundation Staffs to Evaluate New and Ongoing Grants
(Responses of 445 officers responsible for corporate giving)

	Almost Always	*Frequently*	*Occasionally*	*Seldom or Never*	*No Answers*
	Percent	*Percent*	*Percent*	*Percent*	*Percent*
Professional staff analysis	39%	18%	13%	10%	20%
Written guidelines	34	18	11	14	24[a]
Analysis of audit reports	8	16	25	17	34
Cost-benefit analysis	5	11	22	27	34[a]
Other	11	4	1	1	83

a. Do not add to 100% because of rounding.

members of this group were asked to form a Business Advisory Committee to make recommendations concerning various aspects of corporate philanthropy of interest to the Commission. The recommendations that follow are based on The Conference Board study and other studies completed for the Commission.

Leadership

Committee Recommendation

- *That strong corporate commitment, an essential element in upgrading corporate public service activities, be encouraged as being in the best interest of society and in the long-range interest of corporations. There is significant corporate leadership in many public service activities, but there are great differences between the committed companies on the one hand and those with average and below-average interest on the other hand.*

Comment: This recommendation stems from recognition of the fact that leadership is *the* vital component in corporate contributions and other public service activities. The awareness, knowledge and determination of the top corporate leaders set the tone, dimensions and policies for the programs in the companies they head.

The Conference Board study has revealed significant differences between the leadership companies and other companies in various public service activities and in contributions as a proportion of pretax income (see Chapters II and V).

Although this study is primarily based on quantitative data, there are also qualitative aspects to leadership – particularly innovativeness. Corporate leadership takes many forms – philosophical commitment and financial commitment among them.

True leadership is not "letterhead" leadership. Leaders in the corporate world take their responsibilities seriously, become genuinely involved in organizations, and diligently pursue the realistic goals they have helped to set. In addition to the "leading edge" companies, reflecting their top officers' concern, trade associations and industry groups can play an important leadership role in upgrading public service activities.

Management and Staffing

Committee Recommendation

- *That financial contributions and other public service activities of corporations be reexamined to make certain they receive the same quality of management attention that other corporate functions receive and deserve with carefully thought-out policies and goals characteristic of well-managed activities.*

Comment: The Business Advisory Committee believes that the management of public service activities is a complex matter, requiring a thorough understanding of the goals sought and the specific methods used to attain them. Goals should be defined in the contributions and other public service areas as they are in the production and marketing of goods and services.

The earmarks of a well-managed social responsibility program include: clearly defined policies and goals; budgeting for contributions and public service activities, well-organized screening and administrative procedures; application of performance standards to new and ongoing grants. Effective management might entail full-time or part-time staff and the use of outside consultants and organizations.

The organization of corporate public service activities, including contributions, must be tailored to the size and character of the corporation. Some corporations find it effective to organize on a broad basis, using a total resource approach which coordinates management of contributions, urban affairs, community affairs, voluntarism, individual senior management efforts, loans at lower-than-market rates, and other activities undertaken by the company involved. Other corporations find it appropriate to structure such activity on a narrower basis with limited staff attention.

In either type of organization, good staff work is important so that top corporate leadership receive appropriate analyses of public service activities. Management slated to move into top leadership positions should also be involved so that they will be aware of their responsibilities when they move up the corporate ladder.

Accountability and Evaluation

Committee Recommendation

- *The committee believes that corporations should fully utilize appropriate evaluation techniques to measure the effectiveness of their public service activities, new and ongoing grants, and the performance of donee organizations.*

Comment: Corporate accountability entails responsibility that money is well spent. The corporation must measure its performance in its social responsibility programs.

The corporation should also insist upon accountability from the donee. In turn, donees should clearly identify their objectives, define the use they want to make of corporate resources, set up standards to measure their own performance. There is need for consistent, thorough information from donee organizations. As a minimum requirement, annual audit reports prepared by an independent certified public accountant should be readily available and routinely submitted with requests for assistance (see Chapter VII).

Nearly one out of four top corporate leaders surveyed said they would increase charitable contributions if they had more confidence that the programs were successful. Greater accountability and documentation by donees as to their performance would help to instill such confidence.

Committee Recommendation:

- *That an agency, based in part upon organizations presently performing this function on a more limited basis, be established to set minimum standards in the charitable field and oversee their application on a widespread basis.*

Comment: Although standard maintenance work is now performed by the National Information Bureau and the Council of Better Business Bureaus, it is limited in scope. The Business Advisory Committee finds need for an agency to establish minimum standards in the charitable field, and to oversee the performance of organizations and their adherence to such standards.

Communications and Public Disclosure

Committee Recommendation

- *That corporations voluntarily fully disclose their public service activities, including contributions, to meet the expectations for increased public accountability and to demonstrate the corporations' continuing interest and involvement in public concerns.*

Comment: More than nine out of ten companies responding to The Conference Board survey participated in some form of public service activity. It is not generally known that corporations are this deeply involved.

Some companies already include a special section in the Annual Report on contributions and public service activities or issue a special report. Such communication can lead to better understanding of the corporation by stockholders, employees, customers, donees and the communities in which the company operates.

Only a small number of company foundations and corporations actually produce a report for distribution to the general public. Some leadership corporations are doing this, and the Business Advisory Committee believes that this practice has been beneficial and should be encouraged. This would help meet the expectation for increased public accountability and would demonstrate the corporations' continuing interest and involvement in public concerns.

Diversity

Committee Recommendation

- *That corporations and Congress avoid imposing unnecessary restrictions or forcing conformity. Rather they should encourage diversity, which represents the strength of voluntarism and the richness of our heritage.*

Comment: The committee calls attention to The Conference Board study which revealed a great diversity of responses to society's needs while demonstrating the depth of commitment in time, money and manpower to the solution of social problems (see Chapters II and V). This diversity and depth of involvement is most characteristic of "leading edge" companies.

Corporate Foundations

Committee Recommendation

- *That the Tax Reform Act of 1969, which has had a depressant effect upon the formation of new corporate foundations, be reexamined to encourage the* *formation and retention of corporate foundations. Significant numbers of corporate foundation executives believe that corporate foundations can lead to better-managed programs, while others believe direct corporate contributions can be most effectively managed. Both methods of giving should be encouraged as viable alternatives.*

Comment: In making this recommendation, the committee referred to evidence in The Conference Board survey showing the Tax Reform Act of 1969 has had an unfavorable impact on about 10 percent of company foundations in the study. This 10 percent figure is consistent with an earlier (1973) Conference Board study which showed that 24 companies out of 240 with company foundations had terminated or phased out their foundations since this legislation was enacted (see Chapter VI).

Although some corporate executives feel that direct company contributions can be better integrated with the goals of the corporation, others favor a company foundation because it can stabilize donations and often results in a better-managed program. Because the formation and growth of company foundations have been hampered to some extent by the Tax Reform Act, the committee believes it would be desirable to review the act as it affects company foundations.

Taxes

Committee Recommendation

- *That the 4 percent excise tax on foundation net investment income for all private foundations be reduced or eliminated, because it is, in effect, a "tax" upon recipient organizations depriving them of additional financial support.*

Comment: The 4 percent tax is the only such levy on hitherto tax-exempt foundations.

Committee Recommendation

- *That, except for equitable treatment, no additional tax incentives are needed – including the concept of more than 100 percent of contributions as a deductible expense, or providing a tax credit that would result in a lower "after-tax cost" than the present 100 percent deductibility.*

Comment: Although nearly half of the top executives in the survey indicated that greater tax incentives would lead to increased contributions, many members of the committee do not believe that the need is sufficiently compelling to warrant recommending additional tax incentives at this time.

Committee Recommendation

- *That there be neither a minimum tax floor before any contributions are deductible nor ceilings on corporate contributions. The first, according to The Conference Board survey, would have a major depressant effect upon contributions giving; the latter would have a minor effect upon major corporations.*

Comment: Although limiting deductibility of corporate contributions to 5 percent of taxable income has not generally been a constraint (only 7 percent of the respondents to The Conference Board survey found it so), the committee believes – as a matter of principle – that there should be neither percentage floors nor ceilings. The committee believes the 5 percent limitation should be examined with a view toward removing it, raising it appreciably, or recasting it in terms of some concept other than taxable income.

Committee Recommendation

- *That a more equitable way of calculating deductibility for gifts of inventory, other than at cost to a corporation, be sought, even though the provision of the Tax Reform Act of 1969 to allow deductibility at cost instead of at market value is sound in its correction of previous abuses.*

Comment: Prior to 1969, business corporations making charitable gifts of inventory were allowed a tax deduction on the basis of the fair market value of such property. The Tax Reform Act altered the valuation basis of such gifts to cost. While the committee finds this provision generally sound in its correction of previous abuses, there may be other more equitable ways of calculating deductibility. These should be explored.

Committee Recommendation

- *That, in terms of philanthropic activity, the legislative and executive branches be urged to establish and maintain the principle of fair and equal treatment for all corporate and business enterprises.*

Comment: Companies in certain industries are not encouraged to undertake an appropriate share of charitable contributions as a result of legislative or administrative decision. While such differential treatment may arise from, or otherwise reflect, nonphilanthropic considerations of public policy, they have had, and continue to have, serious adverse effects on the levels of corporate contributions. According to the committee, the public interest in encouraging such contributions may not have been given sufficient weight in the formulation of these policies.

Committee Recommendation

- *That taxable income in many cases is an inequitable basis for determining limitations on charitable contributions and that it be reexamined with a view to removing the 5 percent limitation, raising it appreciably, or recasting it in terms of some concept other than taxable income.*

Commment: The provisions of the Internal Revenue Code do not now apply equally to all business entities, nor do they give adequate incentives to all forms of business giving. Therefore, the committee suggests that these provisions be examined with a view toward improving the fairness and equality of treatment of business enterprises.

Under the present law corporate contributions are limited to 5 percent of *taxable income*, while individual contributions are limited to 50 percent of *adjusted gross income* (with special treatment in the case of contributions of capital-gain property and contributions to private foundations). The definition of taxable income for corporate tax purposes reflects the exclusion of certain types of income and the deduction of certain accrual types of business expense. As a consequence, the allowable deduction for charitable contributions as a percentage of pretax income, as defined by conventional business accounting principles, varies greatly from one industry to another and from one corporation to another. Some companies, for example, often find that 5 percent of taxable income is equal to a much smaller percentage of pretax income, and in some instances this acts as a disincentive to charitable giving.

Committee Recommendation

- *That tax provisions applicable to the insurance industry, which act as disincentives for contributions, are out of line with provisions applicable to corporations generally and should be reexamined with a view toward providing the insurance industry with the same incentives generally applicable to other corporations.*

Comment: The concept of taxable income and the manner in which charitable contributions are allowed as a deduction for tax purposes in the insurance industry are notably different from the provisions applicable to corporations generally. As a result, the incentives for making charitable donations are lower for insurance companies than they are for other types of corporations. Therefore, the committee proposes that these provisions of the tax law should be reexamined.

Committee Recommendation

- *That governmentally regulated utilities in the fields of electric, gas, water, communications and transportation services are frequently inconsistently treated by regulatory bodies thus providing disincentives to making grants, and that these industries should be given incentives for philanthropy similar to those available to other corporations.*

Comment: The many governmental commissions, departments, and agencies that exercise regulatory authority over corporate enterprise have considerable power, directly or indirectly, to encourage or discourage corporate charitable contributions. Wherever possible, the committee suggests, these authorities should frame their policies and procedures in such a way that they do not result in the discouragement of corporate philanthropy that is otherwise in the public interest.

Appendix

The following tables deal only with charitable contributions.* They do not cover the costs to corporations of other voluntary programs that are taken as normal business expenses or do not enter into the accounting system — for example, low-cost loans for social purposes.

Table A-1 presents the data on contributions as a percent of pretax domestic net income for all companies (except insurance companies) participating in this survey — grouping the companies by the number of U.S. employees.

The overall figure of 0.74 percent of corporate pretax income contributed in 1973 may be compared with two prior Conference Board surveys: the percentage was 0.73 percent in 1972 and 0.82 percent in 1970.

The Conference Board percentages are well under the national average of 1 percent for 1970-1973 because of the mix of companies in this survey (see Chapter I).

Table A-2 presents the data on contributions for insurance companies providing this information, again grouped according to number of employees. The closest measure to pretax net income (used for other corporations in Table A-1) for insurance companies is "net gain from operations after dividends to policyholders and before federal income tax, excluding capital gains and losses."

From the data provided for this study, it was possible to calculate average contributions per employee for companies with different numbers of employees (Table A-3).

Contributions per employee can be a useful guideline when employees receive some benefits from charitable organizations, for example, United Funds or local hospitals. Even in these cases,

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*The Conference Board maintains a master file of data on corporate philanthropy. Data from this file are available to Associates on a fee basis. For information, address the Board's Public Affairs Division.

Table A-1

Contributions as a Percent of Pretax Domestic Net Income, 1973
(Companies grouped by number of domestic employees. Insurance companies excluded)

Company Size by Number of Domestic Employees	*Number of Companies*	*Domestic Net Income before Taxes (in thousands)*	*Contributions (in thousands)*	*Contributions as Percent of Domestic Net Income*
Below 1,000	9	$ 183,449	$ 765	0.42%
1,000- 2,499	30	505,588	4,375	0.87
2,500- 4,999	71	1,684,882	12,054	0.72
5,000- 9,999	79	2,962,131	24,457	0.83
10,000-14,999	50	2,641,031	24,443	0.93
15,000-24,999	50	4,558,466	37,068	0.81
25,000-49,999	66	11,260,002	105,308	0.94
50,000-99,999	23	3,548,681	30,121	0.85
100,000 and over	14	16,997,655	91,338	0.54
Total	392	$44,341,885	$329,928	0.74%

Table A-2

Contributions as a Percent of Net Gain from Operations after Dividends
to Policyholders, Before Taxes – Insurance Companies Only, 1973
(Grouped by number of employees)

Company Size by Number of Employees	*Number of Companies*	*Net Gain from Operations (in thousands)*	*Contributions (in thousands)*	*Contributions as Percent of Net Gain from Operations*
Below 1,000	1	$ 17,678	$ 103	0.58%
1,000- 2,499	8	131,197	875	0.67
2,500- 4,999	4	125,583	1,396	1.11
5,000- 9,999	6	332,910	3,966	1.19
10,000-14,999	2	244,594	1,061	0.43
15,000-24,999	4	478,686	3,123	0.65
25,000-49,999	2	506,501	3,552	0.70
50,000-99,999	2	295,200	3,653	1.24
Total	28	$2,132,349	$17,729	0.83%

the company's ability to pay and its charitable philosophy are additional guideline factors in setting budget levels.

Ability to pay is a more widely accepted measure for determining contributions budget levels. The primary guideline is contributions as a percent of pretax income (or similar measure in the case of the insurance industry).

It is sometimes useful to consider corporate philanthropy relative to assets, rather than to numbers of employees. Table A-4 presents these data for 384 noninsurance companies in this study.

Table A-3

Contributions per Employee, 1973
(Companies grouped by number of domestic employees)

Company Size by Number of Domestic Employees	*Number of Companies*	*Number of Employees (in thousands)*	*Contributions (in thousands)*	*Contributions per Employee*
Below 1,000	11	7	$ 919	$131
1,000- 2,499	38	66	5,251	80
2,500- 4,999	78	274	13,654	50
5,000- 9,999	86	614	28,525	46
10,000-14,999	52	617	25,505	41
15,000-24,999	56	1,047	40,292	38
25,000-49,999	68	2,297	108,881	47
50,000-99,999	26	1,887	33,776	20
100,000 and over	14	3,955	91,337	23
Total	428	10,564	$348,119	$33

Table A-4

Contributions as a Percent of Pretax Domestic Net Income, 1973
(Companies grouped by size of U.S. assets. Insurance companies excluded)

Company Size by U.S. Assets (in millions)	*Number of Companies*	*Domestic Net Income before Taxes (in thousands)*	*Contributions (in thousands)*	*Contributions as Percent of Domestic Pretax Net Income*
Below $100 million ...	58	$ 1,701,826	$ 14,881	0.87%
$100-199	60	1,169,408	12,023	1.03
$200-299	34	761,706	15,249	2.00
$300-499	39	1,899,649	13,806	0.73
$500-999	56	3,852,353	33,735	0.88
$1 billion and over	137	34,560,147	237,067	0.69
Total	384	$43,935,089	$326,761	0.74%

Contributions as a percentage of a company's assets is a less frequently used yardstick than those previously shown. Table A-5 shows this relationship for all respondents; Table A-6 for insurance companies only. Very little in the way of a pattern is established when giving is related to assets.

Table A-5

Contributions as a Percent of U.S. Assets, 1973
(Companies grouped by number of domestic employees)

Company Size by Number of Domestic Employees	*Number of Companies*	*U.S. Assets (in millions)*	*Contributions (in thousands)*	*Contributions as a Percent of U.S. Assets*
Below 1,000	11	$ 6,990	$ 918	.01%
1,000- 2,499	37	30,966	5,250	.02
2,500- 4,999	76	71,054	13,653	.02
5,000- 9,999	83	133,080	28,525	.02
10,000-14,999	50	70,305	25,505	.04
15,000-24,999	51	130,786	36,297	.03
25,000-49,999	68	137,349	108,861	.08
50,000-99,999	25	104,817	33,775	.03
100,000 and over	14	151,237	91,336	.06
Total	415	$836,584	$344,120	.04%

Table A-6

Contributions as a Percent of U.S. Assets of Insurance Companies, 1973
(Grouped by number of employees)

Company Size by Number Employees	*Number of Companies*	*Assets (in millions)*	*Contributions (in thousands)*	*Contributions as a Percent of Assets*
Below 1,000	2	$ 2,477	$ 153	.006%
1,000- 2,499	8	10,386	875	.008
2,500- 4,999	5	14,913	1,575	.010
5,000- 9,999	5	27,235	3,966	.014
10,000-14,999	2	6,043	1,061	.017
15,000-24,999	4	32,663	3,123	.009
25,000-49,999	2	22,389	3,552	.015
50,000-99,999	2	65,575	3,653	.005
Total	30	$181,681	$17,958	.009%

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Education, Training, and Employment of the Disadvantaged	SPA 4
Public Affairs Challenges of the '70s	PACR 8

Forthcoming report scheduled for publication in 1976:
Annual Survey of Corporate Contributions

Footnotes

1. See Mitchell Meyer and Harland Fox, *Profile of Employee Benefits*, Conference Board Report No. 645 (1974).

2. American Association of Fund-Raising Counsel, Inc., *Giving USA* (1975), New York, N.Y.

3. See Phyllis S. McGrath, *Managing Corporate External Relations: Changing Perspectives and Responses*, Conference Board Report No. 679 (1976).

4. Committee for Economic Development, *Social Responsibilities of Business Corporations* (New York, N.Y., 1971).

5. Seymour Lusterman, "The Blood Business," *The Conference Board RECORD* (February, 1974).

6. For an amplification of this concept and a summary of the provisions of the act as they affect private foundations, see John H. Watson III, *The Impact of the Tax Reform Act of 1969 on Company Foundations*, Conference Board Report No. 595, 1973.

7. See section on evaluation in McGrath, op. cit.

CORPORATE GIVING: RATIONALE, ISSUES, AND OPPORTUNITIES

C. Lowell Harriss[†]

Introduction

One hope for meaningful enlargement of private philanthropy may rest on a belief that corporations will increase their contributions—substantially so—from the annual average of around 1 percent of pre-tax income. Corporations would seem to have the financial ability to give more, and some of them have personnel and organizations that can supplement financial aid in highly creative and useful ways. Other studies for the Commission on Private Philanthropy and Public Needs have documented the needs of philanthropies. And is there not a growing recognition of "social responsibility" which would support expansion of business contributions—not only dollars but also the time and effort of staff who could be freed (at company expense) to serve?

What would lead to a significant increase in corporate giving? If nonprofit organizations, on the one hand, face great financial pressures and, on the other, can show that they offer promise as agencies for serving people in constructive ways, then both the private sector and government can play leadership roles to raise the rate of increase in corporate giving. Businessmen can influence their own companies and persuade others. Congress can alter tax laws to assist philanthropies seeking aid from corporations.

Apparently, most profitable corporations contribute nothing. Four out of five corporations with profit took no contribution deductions at all in 1970.[1] And 69 percent of those reporting gifts deducted less than $500. If corporate giving were to average only half of the 5 percent allowed by federal law, the flow to philanthropies would more than double. The increase of around $1,400 million (1974 levels of income) could mean much to thousands of recipient agencies.[2]

Some philanthropies can reasonably hope for significant expansion of corporate gifts of money and the capacities and time of personnel. If the increase in business aid is used as constructively as appears possible, the general public could benefit substantially.[3]

Scope of Study

Other studies for the Commission examine the financing needs of various kinds of philanthropic programs. Neither federal nor state laws prevent corporations from making gifts that they are likely to want to make.[4] Federal tax law limits deduction to 5 percent of taxable income (before contributions); any excess of contributions may be carried forward and used as deduction over the following five years.

This study examines certain general issues. It discusses the philosophy of corporate giving – arguments pro and con. It summarizes some statistical findings. A final section deals with policy alternatives, chiefly some possible means of enlarging corporate contributions.

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Corporations as the Subject of this Report

The focus is on *corporations.* The term "business" will be used often, however, because it comes nearer to portraying the economic nature of our interest – the portion of the economy that accounts for most production and income creation. Most output comes from, and most employment takes place in, firms using the corporate form.

Nevertheless, unincorporated enterprises, including professional firms, are more important in the total of the economy than is frequently appreciated. For them the rules about the deduction of contributions in computing taxable income are those of personal income tax. The owner(s) of such firms, however, will properly take into account considerations which are broader than those often associated with personal income tax. The business as an enterprise (although not incorporated) may be affected by some gifts. The purposes to be considered by corporate managements in contributions policy apply to some degree to the business aspects of unincorporated companies.

Rules and Attitudes Affecting Contributions Are Subject to Change

All businesses, of course, are subject to conditions made by *market forces* – and also to *governmentally prescribed rules,* including those of taxation. Such rules influence behavior. They can be changed by acts of lawmakers and also by administrative rulings and judicial decisions. Political processes constitute an agency for deliberate "control." Congress can alter the framework within which business functions; it can do so with non-business objectives in mind, for example, aiding or discouraging gifts to philanthropies. Laws cannot make water run uphill – or produce income – but they can set rules about how water – or income – is to be used.

Congress cannot create the capacity for corporations to help nonprofit organizations. Congress can, however, influence the use of earnings which companies obtain in the market.

Decisions about corporate gifts are influenced not only by market forces and laws, but also by attitudes, by conceptions of what is acceptable and what is not the right thing to do under conditions today, by informal discussions and the views of peers, by public opinion reflecting beliefs of what is appropriate for businesses. Some of the beliefs - the propriety of supporting community funds – may rest on established tradition. Such others as concern for the arts or ghetto conditions are newer. Management actions on contributions (rejections of requests, as well as the making of gifts) may result from gradual or more sudden changes in opinion. Opportunity exists to influence practices by persuasion of company officials and revision of tax laws; the last section of this study discusses possibilities. Programs selected for help differ markedly from one company to another.

Variety of Business Aids to Nonprofit Organizations

Analysis of business giving is complicated by the variety of forms it takes.

Some corporations probably limit their involvement to outlays of money. Types of money payments which some companies treat as contributions are classed as business expenses by others. As a result, figures are less useful than we might wish.

Corporations provide varying amounts of personnel time for direct participation in the affairs of nonprofit activities. Some of the most constructive of business help may be the skill and effort and commitment of employees, from the chairman of the board on down the line. Time given may be during working hours, or it may be at night and during weekends. In the latter case there may be question whether the time is an individual contribution or in fact a part of the job for which the employing corporation makes compensation in some form.

Use of company property – an auditorium or meeting room, truck transport, computer time, and so on – is frequent, but we have no data on the extent to which this occurs. In this respect, as in others, corporate giving reflects and supports the characteristics cited for voluntarism.[5]

Aid may also consist of (1) loans made at concessionary rates and (2) purchases on terms more favorable to the seller than available to the buyer from some alternative source. Some banks, life insurance companies, and other financial institutions provide help in significant amounts which do not appear in totals of contributions; in some cases the total sacrifice by the corporation will not be determinable until the loan is finally closed out.

In all aspects of business philanthropy – amounts and results, for example – the differences are great. The author's discussions with corporate officers have revealed even more diversity than had been expected. Companies in the same industry have programs with significantly different emphases. Current thinking and rethinking of policies seeks to improve all elements of company participation. In some cases, notably life insurance, the industry itself makes a substantial effort to coordinate activities of the individual companies.

No single study can possibly portray the myriads of details. This reality flows from a strength of corporate participation. Business involvement assures diversity which, among other things, aids the achievement of human potential.

The term "philanthropy" will be used for the entire range of nonprofit programs. Inevitably, several other terms which have ranges of meaning must be used – contributions, business, social, public, nonprofit, responsibility, and so on. It is hoped that usage in the context will convey the meanings desired.

Historical Background: A Brief Sketch

Railroads broke with the established tradition against corporate philanthropy more than a century ago when they began to support YMCA's as an aid to their own operations. The YMCA movement came to this country before the Civil War. It offered a means by which railroads could help to provide accommodations to train crewmen who had to be away over night. The railroad companies supplied about half of the capital cost of buildings, two thirds or so of the operating expenses, and some other aids on an expanding scale through the latter part of the century.

The YMCA was also successful in soliciting funds from businesses to help support a variety of services. Nevertheless, although the best data are sketchy, students of the subject agree that corporate support of philanthropy before World War I was slight and usually restricted to local situations.

Some successful businessmen, of course, made generous gifts of their personal wealth. To be called a "philanthropist" was an accolade. Corporations as such, however, were not, under interpretations of the law, authorized to make gifts of company property. And both prevailing economic theory and the concepts of what was appropriate for corporations rejected the notion that businesses should contribute to eleemosynary institutions. Whatever may have been contributed occasionally for local purposes, the totals were undoubtedly tiny by standards that have now become widely accepted as appropriate.

World War I brought a major change. The Red Cross and the YMCA both conducted active campaigns. Local War Chests (later to become Community Chests and then United Funds) were established in many communities. Corporations contributed to them as part of the war effort. After the war some corporations, we do not know how many or to what extent, continued to support Community Chests and other local agencies. State after state passed laws explicitly authorizing corporations to make contributions.

Social Responsibility

Discussions of business giving have become involved with concern about "social responsibility." This term means different things to different people – and typically seems more vague than precise.[6] In an important sense it confuses rather than helps in discussing policy because interpretations vary. The term can be so broad as to expand unrealistically the scope of expectations about what any group (or individual) ought to attempt. What, really, is the meaning of this term for a corporation (large or small, profitable or suffering losses), a labor union, a political leader, a farm or trade organization, a university, or a hospital? Openendedness invites misunderstanding, especially as to what may reasonably be expected, not only in terms of aid but also in accomplishments where recipients do not respond as hoped for.

Conditions that flow from the actions of a company, a labor union, or some other entity, may be deemed to create obligations – something beyond what the law calls for. The sense of obligation may have expanded in recent years. The allegation that an obligation exists, and perhaps some sort of implied acceptance, may be relatively new and extending beyond the traditional sense of moral obligation.

Citations for failure to do something that has not traditionally been expected present new problems. Omissions can be blamed on businesses – the blame coming out not only from governmental bodies which have legitimate authority to compel action but also from private organizations which condemn a business for failing to do what they believe would be desirable.

A sense that things could be better leads to urgings that corporations devote more resources to more problems and to increase their commitments to traditional programs – and without receiving in return any reasonable assurance of a net benefit, although somehow, at some time, business self-interest may be served. Vagueness permeates discussion, but lack of precision does not necessarily mean absence of substance and validity. Spokesmen in and out of the business world urge businesses to improve their own total performance. Some elements – for example, product quality, accuracy in advertising, and personnel practices – lie predominantly within the traditional ranges of business activity. Others, and these are kinds which often call for contributions, lie beyond what have ordinarily been considered the normal obligations of corporations. Increasing references to "social responsibility" do not assist substantially in clarifying the issues of contribution policies.[7] More help can be found in specific considerations to which we turn after examining some general issues.

I

POLICY CONSIDERATIONS OF FUNDAMENTAL IMPORTANCE

The potential role of business contributions involves many issues. They are diverse and their importance varies. Those examined first, thought not necessarily more important than some of the others to follow, are oriented toward broader policy questions. Is there persuasive reason for leaders in the private sector – notably corporate officials and officers of philanthropies – to make greater efforts to enlarge corporate giving? Would government serve the public constructively by actions to encourage an expansion of business donations? Can corporations provide aid of kinds that cannot be expected from individuals and foundations?

"... or to the People": The Bill of Rights and Voluntarism

The Tenth Amendment, the last of the Bill of Rights, reads in full, "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, *or to the people.*" [Italics added.] The Founding Fathers in using these words did more than merely suggest that neither the national government nor the states (and localities as creatures of states) are to try to do everything that the people want. Rather, this Amendment would indicate an intended reliance on voluntarism as against the compulsion of government.

Some applications of the "tax expenditure" concept (discussed later) almost imply that all group actions should be that of government. This apparent position is not endorsed openly, but it seems to follow from positions taken on other aspects of tax deduction theory.

High tax rates needed for revenue create conditions that the Founding Fathers never envisioned. As government tries to reduce obstacles created by taxes against private financing of philanthropies, must we conclude that only things approved by lawmakers – only politically determined actions – can reflect the public will and advance the public interest?

The Tenth Amendment assigns wide scope to "the people" in their private, nongovernmental, capacities. Does not the Tenth Amendment call for government to do less rather than more to hamper voluntary and dispersed action as "the people" wish? The desires of minorities, the preferences of groups formed and acting voluntarily, are not merely to be tolerated. People deserve protection from governmentally created impediments – not only as provided in the first nine Amendments but the last as well.

The objectives which groupings of people try to achieve by using non-political agencies will have many features. They will have narrow as well as broad aims. Most individuals have affinities with many groups; the compositions of these groups will differ widely. The Constitution in reserving "power to the people" asserts that government – at all levels combined – is not to be all-embracing. Moreover, the framers of the Constitution have not told us that political action has some claim to moral superiority over voluntary group action.

Whatever the propriety of the tax-expenditure concept in some usages, the application to contributions for voluntary organizations conflicts with the spirit (and letter?) of the Tenth Amendment. The Constitution does not imply that all approvable group actions are governmental. Quite the contrary. A tax law that does not impose obstacles to voluntary group action for philanthropy is not "doing a favor." It is refraining from violating the Bill of Rights.

Maintaining and Enhancing Diversity, Flexibility, and Creativity in Service Delivery Systems: Corporate Personnel and Funds

Other reports for the Commission discuss the role of voluntarism. Businesses can play a vital role. One aspect warrants explicit attention. Corporate contributions aid the maintenance of diversity in the structure of systems for delivering services. (In this connection "service delivery" is broadly conceived to include, among other things, the programs of agencies concerned with beauty, the advance of knowledge, the healing arts, and understanding of public policy issues affecting business.) Corporate funds assist. In some cases they provide immensely valuable supplements to personal gifts. In addition, corporations can sometimes supply *leadership,* staff time, and abilities of varied nature which are in fact unique. Selecting the "right" programs to attempt, and then getting things done, both require more than money. Corporations, it would seem, can do much more than has yet been provided to make the nongovernmental sector more effective.

As contrasted with the use of corporation earnings required in taxes to support governmental projects, some opportunity for voluntary financing and provision of leadership provides more "points of entry" for practical means of influencing accomplishment. Private, nonprofit programs offer opportunities for evolving new methods to meet needs, old and new. Experimental innovation can be undertaken at more points than if government were a near monopolist. Corporate financing has scope on a voluntary basis.

One does not disparage the successes of governmental innovations to call attention to the added potential for the society when private participation has opportunity. A mixed (governmental and private) system permits – virtually assures – some testing, competition, and comparison. More is possible. Year-to-year growth of serious corporate involvement can bring improvements of two distinguishable types: (1) in the allocation of philanthropic resources to reflect judgments on *policy alternatives* and (2) in actual *operations*. Positive results from corporate interest can result in many forms, at many places.

Private commitment – corporate, as well as individual – to programs of education, health, art, and so on, has a potential which can add much more to the total accomplishments than anything yet approximated. The effects of such involvement cannot be measured. It cannot be put into equations which econometricians use in trying to quantify inputs and outputs and measure public programs. The rendering of volunteer services can foster cooperation and interaction among various groupings; no separation of the results attributable to particular elements is possible. But the benefits can be well worth greater effort.

People who otherwise have little or no association with each other, for example, do have contacts in philanthropic activities. An increase in the mixture of membership can be expected to reduce friction among persons from varied groups. Such interaction of volunteers reinforces personal awareness and socially responsible involvement. It helps to foster a sense of community. Corporate financing and staff participation can contribute more in these ways than is yet the case.

Interaction of this type has existed in varying degree in the more traditional community service organizations. Some relatively new organizations have been designed to foster more interaction among groups. Although in theory it may not be impossible to achieve comparable interaction in activities financed entirely by governmental funds, practical difficulties are formidable. Various interests (groups) which are dependent to some degree upon political sources will not always be at liberty to participate frankly and freely. Private funding provides opportunity for entry and the means, and at times stimulus, for flexibility – some participants having disposal of such resources thereby have independence from pressures from which others cannot be free. An element of independence joins with responsibility when corporate personnel are involved.

Mixed-support organizations of many types now draw upon both private and governmental sources for funds and for leadership. Some of these institutions generate unique contributions by acting as conduits between groups with different perceptions and values. Various constituencies are represented, not merely as recipients and suppliers but also as participants.

In addition to voluntarism as ordinarily understood, benefits from private support permit a richer mixture of human abilities. Policies to enlarge private contributions can help in the achievement of results not otherwise obtainable because alternative means do not in fact exist.

To some extent, of course, an expansion of personal giving and individual participation would lead to this general result. But business funds can supplement those of individuals. And corporations can sometimes supply personnel, as noted later.

Preserving the Capacity of the Business World to Perform its Essential Functions

Are there important nonprofit organizations that *only* business will support? Are there activities and programs that are highly desirable, perhaps even crucial, for the enterprise system, for the world of business, and that rely upon it for financing? If so, then corporate giving should give special attention to needs that it alone can meet.

American society has just such needs for business support. Managers, in deciding how to allocate funds for contributions, will consider purposes which to some observers may not seem philanthropic – agencies supporting business interests when issues of governmental policy are debated, business associations such as chambers of commerce, trade association activities, lobbying, development of understanding of market processes and the world in which corporations seek to operate, and so on.

A corporation is limited in what it can use for purposes other than those for rather direct benefit.

What priority scale should be recognized in allocating those amounts? A variety of nonprofit agencies compete for funds. One responsibility will be to protect what is favorable to the enterprise and to oppose things that would hurt it.[8]

A corporation as an entity has responsibilities which can be distinguished from those of the individuals who are its employees and suppliers of capital or the customers it serves. Business units as productive organizations need certain services – for example in lobbying and preparing public opinion – which may be provided *only* by institutions supported by the business world.

Many existing conditions may seem to company managements capable of improvement but require actions outside the scope of any one firm's capacity – changing federal, state, or local law, for example. Antibusiness proposals are made. Legislative bodies get suggestions that would raise business costs, including taxes. Proposals that would hamper operations and impair efficiency may be advanced with good intentions and without full awareness of the effects. Governmental restrictions are advocated and regulations imposed without assurance that they are well designed.

Who stands equipped and willing to present the positions of those companies that would be hurt? Individually, the great majority of businesses will not have capacity to do a fully effective job. Normal advertising, lobbying, and public relations programs cannot be adequate. Organizations to perform such services are not adequately financed by the contributions of individuals.

Some of those who are critical of any corporate giving at all believe that the money should not be contributed but dividends increased. Shareholders as individuals would then have more funds and could step up their personal contributions. Their "own" money would be used to do what is needed to serve their preferences – perhaps, helping to preserve the conditions for business. Such an approach, however, cannot be counted upon to produce all of the results that managements will believe to be desirable. It is not always true that if corporations do not give (or spend) for some purpose the task will be done by other means.

Corporations have responsibilities to their employees, customers, and those who supply capital. Harm to business firms may result from some actions by government or others. And opportunities for improvement in governmental and other conditions may fail to develop because of inaction by the "public." Decision makers in government cannot be counted upon to avoid harmful policies and to develop potentials for aiding business. From the point of view of the majority of the public, managements may be right – or wrong – in advancing or opposing certain policies. So much that is of concern to everyone hinges upon the production system that its protection and encouragement do have far-reaching significance. But disagreement about specific proposals will sometimes be wide. Indifference may be so pervasive that a small minority may exert influence much greater than its size alone would justify. Part of corporate action to protect the interests of enterprise will be through organizations that depend upon business contributions.

Among the factors influencing the conditions of productivity and business performance are some in politics. Being good competitively in the market will not meet all challenges. Normal processes of business will not do all of the job of meeting adverse non-market developments. Those corporation funds available for nonprofit purposes are limited. In competing for them, the organizations that operate to protect enterprise may have an especially strong claim. Corporate leaders may realize that much for all of society depends upon the health, productivity, and profitability of enterprise.

Business as Existing at the "Toleration" of Society: A Misplaced Argument

Sometimes advocates of corporation giving assert that businesses exist only because society permits them to exist.[9] Some people are assumed to be acting (in a way not specified) to do a sort of favor to those (1) who constitute business in producing, as employees and suppliers of capital, and (2) who consume the output. Is not the latter group everyone? And are not producers and their families almost everyone?

The following seems to be implied: "Good behavior" by corporations – perhaps in the form of larger contributions – can protect business firms (1) against withdrawal of the privilege of employing and producing, or (2) from the erection of obstacles to operating. Corporations may in a sense try to take out a sort of insurance against adverse actions. This line of argument grows out of misconceptions.

Does society somehow do favors for corporations, for which "extras" can properly be demanded? Corporation charters, it is true, are granted by political authority. And, certainly, the general environment – people living, working, investing, playing, carrying on their affairs – is the milieu in which the people that are businesses operate. But the arguments reflect a distorted approach to the "public" – that is, the human interest in business. The assertion almost says that people in their capacities as voters or as citizens grant favors to themselves as consumers or as workers or suppliers of business capital.

Businesses are the *source* of most income. Society would be primitive indeed without what people achieve through businesses. From them we get most of our income, most of the products and services we consume, and most of the funds to pay taxes to support government. If the public, or any influential element, comes really to believe that businesses exist at the suffrance of "society," if people believe that somehow the community does corporations a favor to let them operate, then such misdirection of thinking can lead to mistaken policies. Businesses may be pressured to use their resources in ways that are not the best. There is risk of inflicting self-damage by creating conditions that would make business operation more difficult and more costly without *net* gain.

For the public as a whole, self-interest calls for effort to make conditions more favorable to business. The role of corporate contributions is to help improve conditions, not to ward off a sort of blackmail. The reason for such giving is not that the community does some favor in letting corporations operate. Rather, the reason is that in an interdependent economy business organizations can serve us better in their primary activities by aiding nonprofit organizations.

II

ARGUMENTS FOR AND AGAINST CORPORATE CONTRIBUTIONS

The points of this section embrace two rather different kinds of considerations: (1) the propriety in some sense of any corporate concern for philanthropy and (2) the extent and scope of aid when some is to be given.

The arguments range widely. At either extreme – clearly appropriate for a corporation and clearly to be rejected – there are examples that will involve no serious differences of opinion. Through a spectrum which includes a variety of situations, however, marked differences of opinion prevail. They include both (1) the general principles of business giving and (2) specific cases, the "why," and "for what" and "to whom," the "when" and "how," and the "how much."

Attitudes are in flux. On many elements, certainly, no consensus is to be expected. When one corporation makes contributions to certain recipients, why do other companies in more or less comparable positions have programs quite different in amounts and apparent objectives? Arguments which apply in some cases are irrelevant for others. The significance attached by those who make them differs. Several may have some merit, deserve some attention, and yet be very far from controlling.

Arguments Against – or for Narrow and Limited – Corporate Giving

Corporate giving is well established. Arguments in opposition, therefore, may not seem to deserve serious attention. Nevertheless, they are relevant to the Commission's interests.[10]

For the many corporations that give nothing or almost nothing, one or more of the reasons cited below for not contributing must be convincing. Much the same will apply to companies that give little.

Anyone desiring an expansion of corporate giving will wish to have refuted those of the arguments which are now persuasive. Perhaps business managers can be convinced that the arguments do not in fact have substance or that they are outweighed by others. Moreover, even among managers whose companies are high on the scale of contributors (relative to the size of activities) some of these considerations may be keeping gifts below the level that is possible. In one way or another the advocates of greater business aid for nonprofit activities may try to overcome the objections and obstacles.

Profits Inadequate

One reason corporate giving is not larger, of course, is that profits are not greater. Business earnings limit the contributions that corporations can and will make. Disappointing profits restrict giving. Moreover, even assuming that contributions reflect enlightened self-interest and are expected to raise earnings over the years, a corporate management may believe that other uses of funds offer better prospects of improving the company's achievements. Profitability of business will play a crucial role, one which colleges, cultural agencies, and others seeking funds must take into account in their expectations.

Many corporations suffer losses. The fact of loss does not in itself mean that some contributions would not be wise for the company. But lack of profit will certainly dampen the receptivity to appeals for donations.

Avoiding Confusion of the "Business" with Other Aspects of Social Activity

For the "good society" should not the business portion of life be kept distinct from the political and social? Mixing different things may risk the deterioration of each. Moreover, in this case, mixing the private and the governmental may in fact invite the extension of government as traditional dividing lines disappear, leaving areas without clear definition. The business and philanthropic elements, it may be argued, are bound to suffer, in part because politics can use compulsion and expand without reasonable assurance of competence and efficiency.

Corporate Philanthropy as an Exercise of Undue Power

Business movement out of the strict confines of market-determined use of funds into the making of contributions which have no evident quid pro quo raises questions about the exercise of power. Does not the authority to give away funds permit the unchecked exercise of undue power by some managers? In other aspects of business – in buying and selling, in hiring and in raising capital – market forces check management decisions. Limits set by competition provide objective standards. Errors on any large scale will be difficult to overlook as profit and loss statements show results.

Equivalence governs normal business transactions; benefits received are expected to equal payments made. What is worth doing will be indicated by what others acting freely will do in exchange. The recipient must provide as much in value as he receives – no favors to one as against another. Influence does not extend beyond the transaction in the sense that neither party can attach conditions beyond those for which the terms provide compensation.

Corporate contributions, however, are not subject to comparable guides and restraints. Freedom from market tests will permit mistakes – and their repetition. Wasteful contributions practices will not be ended by market forces.

A corporate executive may indulge his own whim – or his wife's – in giving away company property. Individuals may exercise economic power in ways that, albeit well intentioned, are arbitrary. Some may be irresponsible and even undesirable. In the case of large corporations the amounts given may seem to be substantial even though as a fraction of company expenditures the totals will be tiny. The management discretion which makes good things possible also permits of mistakes which are not more or less self-correcting. Within the rules set by corporate and tax law, the scope for error may be considerable.

A potential for the exertion of personal will by corporate officers may be abused.[11] Success in business, it may be argued, does not assure competence to exert influence over other activities; yet competence may very well be transferable.

It is alleged by some that corporate officers can exert undue personal influence through their selection of recipients of contributions. However, this argument is in conflict with the desirability for freedom for creativity, innovation, variety, and diversity in making contributions. Potential benefits from such freedom, one hopes, will greatly outweigh any unwelcome results. Will not possible abuse be forestalled by others in the corporation – from the board of directors, other officers, staff, and a contributions committee? Whether or not checks and balances within corporations seem adequate will depend on which judgments are to check. To some extent, publicity and the competition among agencies seeking funds will tend to prevent serious departures from behavior that meets generally accepted standards.

The precedent of congressional action to restrict certain of the activities of foundations may raise this question: If business aid to philanthropy expands, is there risk of building up political pressures to legislate the substitution of more political for private control over nonprofit activities? (Alleged abuse of management power over *corporate* funds might prompt lawmakers to try for controls on programs financed also by *personal* gifts.) Not only possible abuse of power but another consideration might also lead to a fundamental change of conditions. If corporations begin to get popular credit for things that politicians believe they might handle and get credit for, then Congress has incentive to impose restrictions on corporate giving.

Expansion of the tax-expenditure concept would support such an inclination. Enlargement of the political role over nonprofit activities would follow. (Some recipients might also, wisely or not, prefer governmental action with hope of a rising flow of tax funds.) The role of business giving might be reduced to facilitate a shift to governmental. The effects of such changes would be difficult to forecast.

At the moment, any pressures for enlarging the role of government seem to come from sources other than a desire to reduce business participation. A massive rise in corporate giving might arouse more concern than seems justified now. No contributions increase on such a scale seems likely.

Unreasonable Expectations

Business entrance into areas of philanthropy, art, and so on, which have no limits on what to seek and few or no clear guides about what is accomplished, may invite trouble. A potential for mistakes and misunderstanding can, at least in some cases, lead to costly frustration. Good intentions are not enough for good long-run results. Businesses, despite a sincere desire to act well, lay themselves open to new stresses and strains, new conflicts in conceding even implied responsibility for some kinds of programs. Corporations open themselves to pressures and "demands" which cannot be controlled effectively by principles that have wide acceptance. Bases for evaluating results too often lack precision.

Business Sticking to Business Will Provide Increasing Ability for Individuals to Finance Philanthropy

Using the business system, Americans have made vast economic progress. This advance has enabled them in their private capacities to improve their levels of living and to contribute personally more and more to philanthropies. Will not continued reliance upon the system bring good results? Were not the "failures" of the past in meeting today's standards more the lack of economic capacity than defects of the role of business in society? Some of the short-falls we see today are less those of markets than of politics. The corporate world ought not to be expected to compensate for poor governmental policies. Corporations sticking to *their* job will provide rising real income to permit individuals to enlarge their donations.

Specialization

Specialization and the division of labor serve mankind powerfully and well. We and our children, it is argued, will be better off to avoid endangering the role of specialization in the producing portions of life. If we induce corporations and their managers to take on new functions, then the existing, and most basic, ones will suffer.[12] Efficient production deserves high priority.

Businesses are the agencies we count upon for greater as against lesser productivity (efficiency). Funds devoted to philanthropic purposes are not available for improved capital facilities; staff time so used cannot help in the solution of strictly company affairs. Moreover, the kinds of skills and competitive testing that have brought persons to success in business do not necessarily qualify them for good decisions in philanthropic activities. From the point of view of the broad public interest, it has been argued, their time would tend to be spent less well on community affairs than on the problems of their own enterprise.[13]

Stockholder Decisions Preferable

The testing and the criteria of the market place, it is said, give the best indication of what people really want except as modifications of views are expressed (1) through other voluntary action by persons acting individually and (2) through the political processes of government. Let the corporation do as well as it can in the market. Its stockholders will then have the most income to dispose of; they can make gifts as they prefer, supporting those activities that most appeal to them – or none at all. Such allocation of funds for nonprofit activities, the argument runs, will come closest to indicating real preferences.

Competition Limits Ability to Contribute

Firms in highly competitive positions cannot afford much in the way of contributions. The companies making up much of the business population have only a little leeway for any outlays except (1) those that meet the tests of the market, (2) those gifts made under arrangements for joint action which in fact reduce the opportunities for some competitors to gain advantage by failure to match the giving of others, and (3) contributions that do bring (rather soon) lower operating costs or larger sales.

Doubt About Worth of Results

The results of contributions may not seem to be worth the cost. Programs with which managers are familiar do not appear valuable enough to warrant funds. Many contributions of the company, of other companies, and of individuals may seem to have yielded results of, at best, only dubious worth. Perhaps hopes were too high and the intangibles expected both overblown and elusive. Perhaps measurement and evaluation are uncertain and inconclusive; or busy officers may not take time to examine the potentials for what, after all, are totals small indeed in company affairs. And it may be reasonably clear that some programs for which funds are sought would not be worth the money – to the company, the community, or some larger interest.

This point in one sense overlaps most others, but it has much independent influence. To try to separate it for its own independent effect would be fruitless. Yet failure to note it specially would risk underestimating a force of importance.[14]

Lack of ability to contribute may not be so strong a force, relatively, as lack of conviction that the probable results would justify larger commitments of funds to one or another program or to philanthropy in general. Leaders of nonprofit organizations seeking gifts may have difficulty appreciating the present point – that corporate contributions are being restrained by lack of conviction that results would justify more funds.

Company Could Not Give Enough to Make Any Difference

Many managers may believe that anything the company's gift could add would be too small to make any perceptible difference in the accomplishment of a program. The effects of the corporation's contribution would be "lost in the shuffle." The relatively limited size of a corporation, on the one hand, and the number of potential recipients, on the other, can support a feeling of futility – or give an excuse for not doing what one knows someone should do.

The *total* program may produce results that are recognized as probably or certainly favorable to the corporation. But the particular company could not give enough to make any appreciable difference that would benefit the corporation. It has an opportunity for a "free ride." Why not take it? Why sacrifice when nothing significant can be expected in return? A somewhat related point is that managements will sometimes hope for an "impact effect" to make a difference. Spreading the gift total may diffuse results unduly. One explanation of a company's absence from the supporters of worthy organizations will be a policy of seeking certain kinds of results which cannot be expected from "small" contributions.

Peers and Others Not Giving More

Some corporations would contribute more to a few or several programs or agencies if other corporations stepped up giving. Companies considered to be peers (more or less equal) and others perhaps larger and more prominent are not giving more. Relative position may have meaning. Leadership among businesses to give more can be expected to have some magnified effect over time.

Numerous corporations stand ready to match employee gifts to colleges; the existing level of the company's contributions would go up if employees were to increase their gifts. And special fund drives with matching relate corporation gifts to decisions made outside the company.

Stockholder Objections

Some shareholders have objected to corporate philanthropy. The effect of such attitudes and the publicity given them cannot be judged with reliability. The Conference Board Study prepared for the Filer Commission found that only a few chief executive officers attributed appreciable influence to this element. Whether or not more subtle and less clearly identifiable influences have operated cannot be determined.

Arguments in Favor of (Larger) Corporate Giving

Many reasons are cited for the enlargement of corporation contributions: (1) more dollars and other forms of aid to agencies now getting gifts and (2) an increase in the number of organizations helped. They lack the precision that would help in quantification and especially for guidance on the "how much" that each argument might justify in particular cases.

A fundamental reason underlies others which differ in many respects: *Prudent managements will seek contributions policies that will be supportive of long-run earnings.* Donations should be directed to favor purposes that give prospect of helping to maintain and increase profits – at some time, in some way – as an "investment" which will make the future better for the company. *Benefit for the enterprise* – lower costs or larger receipts, eventually in some form – is the justified reason for any use of corporation resources. Corporations that hope to operate indefinitely look beyond maximizing reported current earnings.

The great diversity of nonprofit organizations and of their functions leads to variety in the more specific reasons that influence management decisions. The persuasiveness of appeals of the arguments cited here will differ from one business headquarters to another.

Carrying on What Has Brought Good Results in the Past: Respecting an Obligation

A feeling of obligation for conditions that have helped to permit success in earning corporation income provides reason for giving to permit continuation of these conditions. The past has left a legacy of indebtedness, intangible, not legally binding, but morally powerful. What a company and its customers now pay for in the market place and through taxes cannot cover all the true costs of today's output. For example, some of the university teaching and research whose fruits are being enjoyed now were paid for by donations in the past.

A sense of obligation to continue good works reflects a feeling of responsibility. Informed concern for the conditions that will make for better business operations in the years ahead calls for aid to nonprofit organizations.

Voluntarism Aided by Corporate Giving

Preservation and expansion of voluntarism, many of us are convinced, will make for a country that is better than if compulsion operates more broadly. Corporate gifts support voluntarism. Pluralism and freedom are valuable, not only as ends of humane life but also as means for attaining many other goals. Corporations have an opportunity to help keep and enlarge the effective roles of freedom and diversity.

There are conditions in every community, as well as in the whole economy, which could – and should – be better. Trying for improvement is *right*, part of the essence of our credo.

Tendencies to turn to government have operated for many years. Doing so permits the use of compulsion, which sometimes seems tempting. But to some people the use of coercion is distasteful or repulsive; and unquestionably the processes of politics and bureaucracy have weaknesses. Results often fall below expectations. And nothing like the workings of market processes can be counted on to adjust, to correct, and to discard the unsuccessful. Moreover, many things that ought to be done are too small or too temporary or too limited geographically to expect people to deal with them effectually through politics.

The expansion of government involves added restrictions, regulations, and taxes. They will affect business, very probably with adverse results. Corporations can suffer from the expansion of governmental coercion, including taxes, for purposes which do not in fact achieve reasonably satisfying results. Voluntary means are an alternative.

The numerous private instruments of a pluralistic society can serve, rather than the singleness (monopoly) of government. Not only individuals in their personal capacities, but also corporations as groups of people can help to finance organizations to meet needs which will not be satisfied by the market system. Corporate contributions can aid the preservation of the diversity, flexibility, adaptability, freedom, efficiency, opportunity, and humanity of a pluralistic society.

Corporations themselves, it is said, will be able to function more effectively in a society of pluralism and voluntarism as against one more influenced by political forces (government and bureaucracy). An expected benefit for the corporation as such undergirds this argument for contributions.[15]

Improving the "Climate" for Business

The general environment, broadly conceived, affects, for good and for ill, business operations. No corporation can "control" all elements of the economic environment which influence it. Tangible and intangible characteristics of the community, locally or nationwide, do make a difference.

Corporations at costs which are not too high can improve the conditions "around" – the plant, the city and its surroundings, or the country as a whole. Many elements of the environment affect business – for example, age of the population, education, race, sex, health, and the quality of the culture. More and more interests, including urban affairs and the arts, come within the scope of concern of some managements.

Some things that might help to improve the environment for business cannot be purchased in the way a company buys a better machine. But dollars and staff time contributed to private organizations can aid. And in some cases business help for governmental agencies may assist in building a better community.[16]

This reason for corporate giving overlaps others. But the objectives and the effectiveness of efforts made and the possible alternatives will often be unclear. The results hoped for will generally make for what most Americans consider a better world, benefiting more than the corporation. But a caution is called for: Not everything that serves such ends will be worth the cost to business.

Improving Community Conditions Can Help Employee Productivity

Conditions in the community – notably health, educational, recreational, and cultural facilities – will affect the ability to attract and to retain employees and their productivity. Amenities can make a significant difference. Not everything desirable will be self-supporting to the extent that would benefit businesses. Provision by government may also fall short of what is attainable and desirable in quantity and quality. Employers have the opportunity to benefit their companies by using funds, and often staffs, to supply community facilities which would otherwise not be available. Aids to improving local government, including the prevention of crime in the streets, can be favorable to the company.

Colleges and Universities Provide Training and Conduct Research

Aid for higher education has been one of the larger forms of corporate giving. One reason is a belief that colleges and universities are important to the productivity of the business world.

They provide workers of higher and more varied skills than would otherwise be available. Even though employers must expect to pay college trained workers what their services are worth, the business world will benefit, it is argued, from a larger, as against a more limited, body of men and women with advanced education.

Colleges and universities conduct research which directly and indirectly contributes to the effectiveness of enterprise. Basic research and other types of inquiry whose results cannot be patented will not be conducted to the extent desirable by companies which must earn profit to continue.

Corporate aid for private institutions of higher education gets support from an additional consideration. Our system consists of some colleges and universities that are supported predominantly by tax funds and some that are private. Corporate tax payments help the first group. Contributions to nongovernmental colleges and universities will help to meet their needs, to balance somewhat the amounts going through taxes, and to reduce the pressure for more government colleges and higher taxes on businesses. The real purchasing power of income from endowment has often dropped as costs have gone up. Thus, the need for annual gifts has grown.

Personnel from Businesses Can Supply Useful Skills

Men and women with special skills and experience in business can sometimes help philanthropies substantially. Nonprofit agencies can draw upon managerial capacity which will aid greatly. As a practical matter, the qualities of aid might not be obtainable on terms of a competitive market. The potentials from a flexible, adaptable supply of managerial effort are greater than yet realized. Large corporations can provide personnel ability which otherwise would never become available to nonprofit agencies.[17] This particular development would rarely be possible in an economy of small and medium-sized companies. The firm of moderate size nationally may be large enough to provide some help to local nonprofit institutions.

Society is evolving a means of supplying services to nonprofit activities. (Big) business provides a form of "social output" which can represent uniquely valuable services – something never "planned" nor considered in discussions of industry structure. The nonprofit organizations gain from the contributions of time of staff of corporations. And the story does not end with the improvement of philanthropic operations.

The employing corporation may benefit from the experience gained by staff members as they participate in management or other aspects of the operation of nonprofit organizations. Persons who serve on loan for a time can get a broader perspective and deeper understanding of the environments in which the corporation operates. Management training may be a byproduct. The experience gained can add to the value of the employee for the corporation itself.

Tax Interests of Shareholders Vary

Owners of closely held corporations who in fact control the distribution of profits may in some cases incur less tax for a given amount of contributions by having the corporation make the gifts instead of paying tax and voting dividends, with the owners then contributing from dividends. In other cases, however, the owners' marginal tax rates will be such that they should try to get the charitable deduction. The great majority of stockholders of larger corporations are subject to marginal tax rates below the 48 percent (plus any state tax) paid by the corporation. Therefore, more tax will be saved if contributions are made by the corporation rather than by shareholders. It is doubtful that such thinking plays a significant role in decision making. But if more sophisticated approaches do gain influence, this consideration may add some reenforcement for expansion of corporate giving.

Building Public Respect

Contributions help in building public respect. Views about the importance to try to attach to obtaining recognition differ. Gifts may be made almost regardless of the prospects of strengthening the corporation's position in the community – if a project seems deserving. Frequently, however, contributions are influenced by prospects of aiding the corporation's public relations and advertising programs. Visibility and respect have value to a company. They will not substitute for substance in business operations, but without them a company cannot always get full advantage of its achievements.

Staff contacts in the community can be helpful to a business which must have dealings with agencies of (local) government and with other organizations.

Corporations in various aspects of the total of their activities may be affected by the esteem in which the company is held. Although philanthropy may seem to be inconsistent with self-interest, managers will properly try to build favorable recognition, perhaps only intangible and chiefly over the long run. Will aid to certain nonprofit programs not only support activities that are desirable but also help convey a belief that the corporation "does care" and "has a heart," that it is associated with "quality and exellence," that it "presses to advance the frontiers of . . .," that "concern for public needs" gets support?

A tendency in some minds to associate altruism with what is proper giving may seem to discredit any effort by the donor to seek advantage from contributions. Such a view, however, is more misleading than appropriate for a corporation. Mutuality of interest – of donor and recipient – is an approvable objective of corporate giving.[18] Facing many and varied solicitations for contributions, managements in choosing among alternatives can weigh the probable results in employee, customer, and investor attitudes and in public relations and as supplements to advertising.

Attaching conditions to gifts to benefit the corporation directly would rarely be part of donor policy. But hope for recognition will sometimes seem to belong in decision making.

Continuation of Contributions Practices: Commitment

Custom, precedent, and pressures account for some giving. Because of (1) momentum and (2) the actions of those around them, managements may feel that in fact they have only limited choice. Gifts cannot be cut off. In practice even major reduction would be exceedingly difficult. Commitment of directors and senior officers to particular programs, according to the Conference Board survey, has considerable influence; pressure from "business peers, customers, and suppliers," however, is much less significant.

Diversification as a Reason for Shareholders to Support Corporate Contributions

Many stockholders own shares in several companies. And persons owning indirectly through mutual funds and pension funds have interests in dozens of corporations. To the extent that corporate giving does aid business in general, the contributions of particular businesses are supportive of other companies. External benefits (described in the next section) are greater, it is argued, than anything associated with a single company's giving. A corporation in making contributions serves the entire business sector, as well as particular companies. This argument would justify more and larger gifts than might otherwise be approved.

Economy in Raising Funds

Administrative and compliance costs of raising funds for nonprofit organizations may be somewhat reduced per dollar received if corporations rather than individuals account for some of the total. Large contributions from corporations may absorb less in human effort and other solicitation expense than dozens of smaller ones for the same total. For both the soliciting agencies and the shareholders the costs of hundreds of appeals and payments are larger than a single gift by the corporation. What are in a sense "dead-weight" elements in the total of philanthropy can probably be reduced by the development of arrangements for getting funds in larger units.

Any validity in this point would give reason for some "tilt" of governmental and private policy to encourage corporate giving. Nevertheless, however, caution is called for; business giving should be dominated by prospects of benefit to the enterprise.

An additional, and major, argument calls for somewhat longer explanation.

Externalities

Two distinguishable points are discussed together in this section: (1) A company can help to finance activities which are desirable to it but whose benefits exceed any it can capture. (2) The reality of such benefits creates persuasive reasons for active governmental encouragement of corporate contributions and for business leadership to try to expand voluntary giving.

Positive *externalities,* for the purposes of this study, are good results that do not become the property of the company which makes them possible. They are outside – external to – the corporation, as distinguished from the benefits a company gets from the sale of a product. The proceeds from sale will be "internal": the company gets them. The profit motive will not always provide incentive for a business to do as much as is really worth doing.

Business outlays on art, health, and civic affairs produce benefits which are spread widely over the community. They can be worth more than they cost. Yet no single company may feel that it will harvest enough advantage to justify incurring all or much of the cost. What, then, might induce more of the varied actions which in a broad sense are worth doing?

The economic theory of externalities supports something "extra" to induce more business giving for certain activities; society or the business world as a whole would get benefits greater than the costs.

If many business firms, perhaps 50, were to provide more aid to civic affairs or recreational or youth aid programs, perhaps $500 more by each company, the advantages from the use of the $25,000 might benefit each company by an amount greater than the $500 of its outlays. Yet, if only a few were to provide $500 each, the others doing nothing, the gain would be too slight to justify the gifts. Certainly no one alone can make possible what each one can get if they follow parallel action.

In a competitive, enterprise economy the market will provide most things that people want badly enough to cover the full costs of supplying them. Self-interest will induce production. Suppliers can earn income by providing what consumers will pay for. Things consumers do not want with enough intensity to cover the costs will not be forthcoming. And those consumers who will not pay a price adequate to keep the supply coming can be excluded from getting the items: If a person will not pay for another pair of new shoes, he will not get them.

There are, however, what economists call "public goods." If they are provided at all, they automatically become available to about everyone. National defense and research which adds to knowledge in the public domain are examples. Street cleaning is an example of a more limited kind. Whether the group benefiting is large or small, if the service is provided for one, others also get it regardless of their payment or nonpayment. "Free riders" can benefit. Exclusion of those who will not pay is not possible.

There are some public service programs, some activities of nonprofit organizations, that will benefit many companies if the service is provided at all. If any small minority of them paid all of the costs, they would be supplying benefits to others – "external benefits" so far as the suppliers are concerned. The advantages to the few corporations might fall far short of the total expense of supplying the services. They cannot, then, be expected to finance the supply. But each can afford to bear part of the cost because of benefits it will receive. And for the group as a whole the advantages could be above the total expense.

Where such conditions exist, one method of getting the output is to use political processes and compulsion. Governments can force people to pay. We do utilize governments to supply and to pay for many things of a public-good nature. Are there not, however, gaps and shortfalls in the supply of services whose total benefits would justify the total expense needed? Of course. Do not the political system and bureaucracy and taxation and compulsion sometimes leave much to be desired? Of course.

A nongovernment means does exist. We can obtain services which yield benefits beyond those for a specific company or individual by arranging joint efforts. A group organized voluntarily may agree to finance the project. Each member will be better off by paying a portion of the cost and sharing in the total benefit than if the service were not provided. (The group is large enough so that taken together the firms capture the positive fruits.)

Here is an opportunity for cooperative effort of some kind. Higher education and some kinds of research offer examples. The training of scientific and managerial personnel will affect many companies. Yet any one company contributing to one college or to a group of universities cannot count upon obtaining as employees the persons who are trained as a result. Competitors may benefit. And most of the students who benefit from the gifts may not in any discernible way be suitable for the future needs of the particular business. Who can know what the training may be?

Companies acting on their own individually will not pay for as much activity of sorts with external benefits as would be to the advantage of business as a whole – and to the community and economy in general. Education, artistic, health, and other activities for whose costs corporations are asked to contribute do have positive externalities as far as any one corporation is concerned. The benefits paid for by some contributions cannot be fully "captured" by the company making them. A dollar given to a college or a health program may produce at least a dollar of benefit just as does a dollar spent on labor. But in the first case the benefits accrue broadly over the community, while in the latter case the company gets the worth of what the employee produces in return for his wages.

Responsible corporation managers will have reason to emphasize giving for those programs where benefits to the company – at some time, in some way – are more likely to approximate what the company contributes. Companies acting individually will make fewer gifts than would "pay off" well for them if the total interests of the community (or country) were considered. However, if the scale of giving (of money and leadership) *does* expand, the total of benefits can be large enough so that individual companies gain more than they spend. The total project can be highly productive. (The possibility of a very rewarding eventual result does not by any means assure such an outcome.)

Voluntary action can elicit widespread support. We do see corporations and individuals freely – and as a result of various kinds of leadership – financing joint efforts. United Way programs meet some of the need for cooperative support. Others might be cited. The potentials of consortia as mechanisms for group operation of a voluntary nature offer considerable promise. Leadership, of course, will remain crucial.

Because of positive externalities, government as an agency acting for the total public can serve a useful purpose by *encouraging* corporations to make larger contributions, and for more purposes, than would otherwise be acceptable to companies acting individually. The public is using government performance and taxation to provide services with large elements of externalities. (Indirect methods through taxation will be discussed later.) The total of benefits, including externalities, for the community as a whole could be enough to justify what to some critics might seem to be a significant "tax expenditure." Moreover, if the programs – on balance, over time – were successful, benefits to businesses in taxable earnings might exceed any initial tax reduction. Such speculation does not, of course, prove the result.

III

TAX CONSIDERATIONS

References at numerous points earlier in this paper have indicated the major types of tax treatment of business contributions. Other studies for the Commission have dealt at length with various issues in this area so that the discussion here can best be limited and directed to selected aspects of the total picture. Importance attaches to two opposing possibilities:

1. Some erosion of established features (deductibility) may grow out of a new approach; no immediate challenge appears, but ideas can gain influence. The tax-expenditure concept may be extended to business contributions. Conclusions which may be appropriate in some applications of the concept may be transferred to corporate donations without full understanding of distinctions. There may follow, then, criticisms which, quite inappropriately, support policy changes that would hamper the growth of corporate giving.

2. In contrast, tax policy represents one way by which people acting through government can encourage business aid to nonprofit organizations. If lawmakers favor an improvement in conditions in which private agencies carry on their activities, the tax law can be altered. Taxation, to restate, is an element of the economic structure or framework which collective action, government, can alter. The conditions influencing what people do in voluntary and private support of nongovernmental activities can be altered by what people do in making governmental decisions.

High Tax Rates

One fact flows from high tax rates. The corporations that account for most of the income earned in the corporate sector pay around 50 percent (federal plus state taxes) on incremental earnings. Such levies, on the one hand, reduce incomes and the ability of business to help philanthropies (the "income" effect). On the other hand, however, high marginal rates do in a sense reduce the deprivation resulting from a deductible contribution ("price" effect).

Tax Expenditures

Long-established tax rules are being questioned. What government does not take, we are being told, is a "tax expenditure." Should these amounts not be examined, perhaps even determined, by Congress year by year, as are outright federal expenditures?

The deduction of contributions does reduce the tax otherwise payable. The Congressional Budget and Impoundment Control Act of 1974 requires the executive branch to submit, with the President's budget, estimates of tax expenditures. Assuming that donations would be the same regardless of tax treatment (clearly, such an assumption is *not* valid!) figures are given as to the amount the Treasury does not get because of the deductibility – $440 million for corporate contributions in fiscal 1976.

When government takes as much as it does today, not taking still more may hardly qualify as "subsidy." Yet advocates of treating the "nontaking" as "subsidy making" point to the effect of the tax provisions on relations among alternatives. The deduction possibility enables the taxpayer (individual or corporate) to influence the *use* of his (its) funds to a greater extent than if he (it) did not make the contribution and then paid more to government. More choice remains to individuals and voluntary associations, including businesses, as distinguished from collective action through the processes of government. Because contributions reduce tax receipts the decisions of political authorities have less influence on the actual use of funds (and the things they buy).

Contributions by *individuals*, of course, provide benefits for others rather than for the donor.[19] This report, however, deals with corporations. For them, as we shall see, substantially different considerations apply.

The influences of tax laws differ from those of the market place. There, the expectation of mutual benefit guides as someone sells his labor or a pair of shoes and someone else makes a payment. Taxes, in contrast, are compulsory. No assumption of quid pro quo is made. The nonpayment of tax does not as a rule deprive the non-payer of government services.

When deductibility of a donation reduces payment to the Treasury, the taxpayer does not suffer by an equal loss of government services. In such cases, then, is it correct to conclude that the amount that government does not take is a "subsidy" or a "tax expenditure"? Does government give up something that "belongs" to it?

Amounts that government does not force corporations (or families) to pay when it has the power to do so do not fit into traditional categories of *expenditure* by collective agencies. "Not taking" does differ from "making an outlay."

In allowing the deduction of contributions, government is not refraining from taking something which "belongs" to it in a recognizable sense. Assume that philanthropies get $X from corporations. Taxes on the companies are $X less than if the contributions had not been made. Are the $X that the Treasury does not get the $X that political processes (government) created? Creativity is cited here as a criterion because it must be one source of rightful possession, of "belongings." Perhaps *creating* in the sense of producing is *the* origin of the legitimacy of acquisition. Stretching of the application of words, as in using "tax expenditure" to apply to contributions, does not establish validity whatever may be the appeal in other circumstances.

The amount not taken in taxes when a donor deducts a contribution is not something that economic processes assign to government on the bases of some "proper" attribution based on government creation. A person works and produces. A business produces. The portions of a family's, or a corporation's, earnings that do not go in taxes can be used in different ways. What tax deductibility does is to alter the relative attractiveness of deductible and nondeductible uses – significantly so when tax rates are high. But the gifts are not federal property; the outlay is private, not governmental. Deduction helps to preserve the apparent intent of the Tenth Amendment.

Difference Between Personal and Corporate Contributions

A difference between personal and corporate contributions requires clarification. An individual making a contribution presumably hopes that the funds will do something that he approves of. The satisfactions he seeks will be intangible and not quantifiable. Benefits are not expected to flow to the donor from the receiving agency; philanthropies do not offer a quid pro quo to the person for making the contribution. He would not ordinarily expect a benefit in the form of larger income or lower expenses of getting income.

Where intangible satisfactions are a sort of "consumption" benefit – an improvement in the quality of his world – tax deductibility does reduce the "cost" of this method of disposing of personal income as contrasted with the use of income for clothing or other consumption, or for saving. No way exists, however, for judging whether such satisfactions as realized are worth, say, one tenth or two times the costs to the donor. Enormously more important, however, is the fact that most of the *benefits* from contributions accrue to others – to a student getting a scholarship, for example.

For a corporation, however, matters are not the same. Generally, although exceptions can be expected, if a company's officers decide wisely in making contributions, the business will benefit, at some time, in some way. Eventually, therefore, income on which tax is to be payable will be greater than if the contributions had not been made.[20] The *deduction* of the business gifts that made the eventual benefit possible is not only appropriate, it is *necessary* just as is the deduction of wages or the cost of materials – to compute accurately the expenses incurred in arriving at a figure of net income. Deductibility is essential for an accurate measurement of business net earnings over time. It is not a concession; it is not a matter of grace.

For corporations, therefore, the allowance of deduction should not be thought of as some sort of special favor or privilege. Whether or not one may believe that to some extent the term "tax expenditures" applies correctly to the personal deduction of contributions, it cannot have validity for properly made corporation gifts any more than it would if applied to the payments of wages. For a tax based on *net* business income, there is no privilege for the company in deducting expenses. To deny deduction of donations would be to discriminate against one type of expense – outlays deemed promising for helping to achieve objectives of the enterprise, in some way, at some time.

Nor is there reason in logic for restricting the deductions to 5 percent, or any such figure. Deduction of wages, interest, and other "ordinary and necessary" outlays that make possible the total results of a company's operations are not limited. Typically, they are many times as large as taxable earnings. Would anyone contend that the tax reduction portion of wage deduction is a "tax expenditure"? Of course, not all business contributions will be successful as judged by either well-defined or quite imprecise criteria. Some, however, may be more rewarding per dollar than are some dollars spent on wages, interest, or machinery.

No tax law could possibly identify degrees of accomplishments of widely different nonprofit activities. An especially important aspect grows out of the possibility of *externalities favorable to the community*. Some contributions can bring benefits to the public which are greater than the cost to the corporation. Public policy, therefore, can wisely give positive encouragement to corporations to do *more* than their own direct self-interest would justify.

Self-Interest Element of Business Contributions

Advocacy of business giving quite properly stresses the expectation of benefit – at some time, in some form. Companies are urged to give because in some way they will be better off. *Enlightened self-interest* is widely cited as the chief, the overriding, reason for business giving. The company will benefit, in the form of larger receipts or lower costs, as conditions are bettered.

One can imagine critics of corporate giving tending to disparage motives that have overtones of self-interest. Yet for business contributions the appropriateness of allowing the deduction must be even clearer than if pure altruism were involved.

A corporation's officers making the decision to contribute company funds, as distinguished from their personal giving, ought to expect the business as such to benefit, now or the future, tangibly or intangibly, to be better off in the long run than if the contributions were not made. The language of the *A.P. Smith Mfg. Co* v. *Barlow* decision supports this conclusion.

Cost of Deductible Gifts

The fact that contributions are deductible in computing taxable income leads to the familiar conclusion that the "cost" to the corporation per dollar given is the dollar minus the marginal tax rate. For the typical large corporation the *marginal* rate will be about 50 percent or a bit more – 48 percent of federal tax plus a few percentage points representing the effect of state taxes (net after allowing for the deductibility of state tax in computing income subject to federal tax).

Some large corporations pay state plus federal income tax at average rates appreciably below 48 percent of pretax earnings, as computed by standard accounting methods, because of the investment tax credit, municipal bond interest, foreign tax credit, and other factors. For most of these companies, however, the burden on *marginal* dollars of income, and the "saving" for marginal dollars of deduction, will probably be around 50 percent.

A contribution of $100 reduces the net remaining for shareholders by $50. Most corporations, of course, are of modest or small size. For them the marginal rate will be nearer the 22 percent that the federal government imposes on the first $35,000 of earnings.

Thinking about the cost of contributions may be more realistic if one looks a bit deeper. What must the corporation do to be able to contribute a dollar? It must make the effort necessary to earn a full dollar. In one sense, what it gives up is not 50 cents for shareholders but whatever was required to get $1 of income. Having succeeded in earning the dollar, it can choose whether governments and shareholders will each get 50 cents or the philanthropy $1.

A company can provide $1 for philanthropies by giving up, say, 50 cents which it could have kept. But to replace that 50 cents for shareholders, the corporation must earn not another 50 cents but another $1. It is hoped that the contributions will enable the company to offset what it has given up.

During World War II and again during the Korean conflict, excess profits taxes imposed exceedingly high marginal tax rates on some corporations. The cost of giving as ordinarily conceived dropped markedly, sometimes to only a few cents on the dollar. Contributions rose.

The excess profits taxes, of course, also made the retention for shareholders of marginal earnings far more difficult. To keep $1 for stockholders, corporations subject to excess profits tax had to earn many times as much as $1. These high taxes, however, were expected to be temporary. It became sensible to use funds in some ways which were currently deductible but which were expected to yield benefits over the longer run when marginal tax rates would be much lower. In the short run, therefore, some contributions, that is, to company foundations, were governed by considerations quite different from those which apply normally. Calculations then applicable had validity because the tax conditions were assumed to be temporary.

A different set of conditions applies to life insurance companies. They pay income tax under separate provisions. Contributions in some cases bring no tax benefits. The cost of donations – to shareholders of stock companies and to policyholders of mutual companies – is the amount of the gift. Whether or not later benefits will to some extent enter into the income on which life insurance companies are taxed (their investment income) will depend upon widely differing conditions.

IV

THE RECORD: STATISTICS AND COMMENTARY

The record of corporate giving from 1936 to 1964 was the subject of detailed statistical analysis by Professor Ralph L. Nelson in his book, *Economic Facts In The Growth Of Corporation Giving,* which draws upon data from income tax returns and other sources.[21]

The Conference Board has for many years conducted surveys of corporate giving.[22] The Treasury Department has made special tabulations for the Commission – comparisons of 1940, 1950, 1960, and 1970 by asset size and by industry and data from 1970 corporate income tax returns.

Historical Record

Professor Nelson analyzed corporate giving from the 1930s to mid-1960s as reported on tax returns. Such figures do not, of course, include (1) some amounts deducted as business expenses but in fact including elements of philanthropy, (2) the worth of staff time and probably most "in kind" contributions (for example, use of facilities), (3) potential earnings sacrificed when loans are made at concessionary rates or transactions are concluded on terms less favorable to the corporation than available elsewhere.

The following table shows corporate giving figures for selected years.

Corporate Charitable Contributions, 1936-1970

Year	Contributions (in millions)	Contributions as a Percent of Net Income
1936	$ 30	0.38%
1940	38	0.41
1945	266	1.24
1950	252	0.59
1955	411	0.86
1960	482	1.11
1965	785	1.05
1968	1005	1.15
1969	1055	1.28
1970	797	1.17

Source: Office of Tax Analysis, U.S. Treasury

During the 30-year period corporate gifts rose at a rate *three times* that of the increase in gross national product – from one thirtieth of one percent of GNP in 1936-40 to one tenth of one percent in 1960-64. Contributions also rose as a percentage of corporate net income. In the latter period they were three times the percentage of corporate profits of the earlier years. Clearly, business practice changed substantially.

The size of the corporation did not in itself appear to influence the proportion of earnings contributed. The time-series and cross-sectional analyses both agree on this point.

The re[illegible] leaves no doubt thatcontributions were associated with the changes in tax rates. The higher the marginal tax rate, the lower net cost to donors, that is, the "price" of giving. From 1936 to the mid-1960s Congress made several major changes in corporate tax rates. In World War II and again during the Korean conflict, excess profits taxes with very high rates were temporarily imposed. Statistical techniques used to study the influence of marginal tax rates as distinguished from other factors yielded clear results. Corporate contributions increased when marginal tax rates rose, so that the "price" of deductible gifts fell. Tax laws *did* make a difference.

Although Professor Nelson notes that the measurements are subject to "a considerable degree of qualification," in the short run, giving did not appear to respond appreciably to changes in the rate of return on shareholders' investment. The number employed by a corporation, however, did have an important influence on the percentage of the company's income contributed. Corporations engaged in labor-intensive production gave more in relation to earnings than did those that were relatively more capital-intensive.

The relationship of corporate size to giving requires more than casual examination. Figures showing smaller corporations relatively more generous than large ones are somewhat misleading. For one thing, smaller corporations have good tax reasons for treating what may be profit (earnings on equity capital) as executive (owner) compensation; the latter, unlike dividends, will be deducted before computing corporation income tax. Adjusting for officers' compensation, and making allowance for other factors to get corporations of all sizes on equal treatment for statistical analysis, Professor Nelson concluded that "large corporations are neither more nor less generous, relative to their income, than are smaller ones."[23]

1970 Figures

We do not know how 1970, the year for which the Treasury made special tabulations, compared with earlier and later years in the respects covered. Total corporation profits were about $10 billion (approximately one eighth) below those of 1969 and 1971; as shown in the preceding table, gifts as a percentage of earnings were below the 1969 figure but nearly the same as for 1968.

The findings from the returns of 1.7 million corporations for 1970 confirm some impressions from other studies and also reveal new facts.

A large number of corporations – 80 percent of the total, and 68 percent of those with positive income – made no deduction at all for contributions. Did so many in fact give nothing? May they have included their contributions as business expenses? A few, 2.2 percent of all corporations, made gifts even though they suffered losses.

The contributions made came chiefly from big businesses. Almost half of the dollars contributed were from the 516 that made average total gifts of over $200,000 (the average total amount given was $755,000). In relation to net income, donations of those giving over $200,000 were virtually the same as for all corporations making gifts–1.16 percent of net income as compared with 1.17 percent. Nearly 29 percent of total gift came from companies with assets over $1 billion.

The 61,076 corporations giving from $500 to $1,000 in 1970 contributed 1.45 percent of their incomes on the average. If all corporations were to contribute at the average of the 99,055 giving from $500 to $25,000 – approximately 1.45 percent of net income – the total would have been one quarter larger.[24]

One of the most unexpected revelations of the special tabulation is this: More than one fourth of total corporate contributions, 26.6 percent, came from companies contributing more than 5 percent of net income. This group made up 3 percent of all corporations – approximately 51,000.

The corporations giving 5 percent or more of net income constituted 29 percent of those making contributions of $500 or more. The 5 percent statutory ceiling, therefore, may be of more importance as a limitation than national averages have led observers to expect. These companies, of course, have gone above the ceiling and made gifts for which no deduction had been allowed in 1970. Perhaps they and others would do more if the ceiling were raised.[25] There are companies which for one or more reasons have policies of giving which are far above average. Some would probably enlarge their contributions over time if tax considerations were not restrictive. The corporations giving 5 percent or more will for the most part be smaller and medium-sized firms.[26] The average contribution of corporations giving from 4 percent to 5 percent was $5,500. Assuming that the contributions of this group averaged around 4.5 percent of income, the net income was around $122,000. Quite possibly some of the corporations were firms closely owned; company gifts may have been to some extent substitutes for personal donations.

Almost half, 47 percent, of all gifts were made by corporations giving 3 percent or more of net income. They earned only 9 percent of total corporate income.

Among broad industry groupings, manufacturing stands out as the source of clearly the largest amounts.[27] Almost half of all manufacturing corporations (48 percent) made contributions – averaging $3,320 – and these accounted for half of the total of gifts deducted. Yet manufacturing corporations made up only 12 percent of the total number of corporations and had only 19 percent of assets. The companies making gifts owned 95 percent of industry assets; obviously, the non-givers were small in terms of assets.

Finance, real estate, and related corporations accounted for 17 percent of total gifts, averaging $550. Transportation companies averaged $490 in gifts. Communications corporations deducted gifts averaging $5,280; yet 66 percent of the companies in the groups deducted nothing as contributions. Electric, gas, and sanitary services corporations made gifts averaging $7,770; they had 4 percent of the assets of all corporations and made 4 percent of all contributions. Contributions of corporations in both wholesale and retail trade were relatively larger than their assets, but modest indeed – averaging $450 and $330 respectively. Corporate farms deducted contributions averaging $110. Profitable corporations in agriculture making no gifts had almost half the assets of the industry (48 percent). In services, 37 percent of profitable corporations showed no gifts.

Some firms with assets of over $1 billion and positive incomes – 85 of the 346 corporations in the group – deducted no contributions. On the average they had earnings which were low relative to assets; they had 37.1 percent of assets in the group and 8.2 percent of net income. But the fact stands that some big corporations with net income apparently contributed nothing. Why? What large corporations made no gifts? It may be that some were associated with others that made gifts. Or a corporate foundation may have made contributions and in the particular year have received none.

Among corporations making donations, those with asset size of $50,000 and under gave, on the average, about as much in relation to income as did those with $500 million and over. (The dollar totals, of course, differ tremendously.) As asset size increases, a larger percentage of corporations reported contributions (except for the $1-billion-and-over class). In all groups there are enough corporations making gifts that in relation to earnings exceed the average substantially – say twice the national average of slightly over 1 percent – to suggest that a large potential remains, not only the many "non-givers" but also those that are materially below others.

To close with reminders: (1) The gifts of staff time, materials, and equipment, and the free use of facilities, do not appear in these figures; (2) business expense deductions may in fact include some contributions; (3) loans and some other transactions may involve terms that in fact represent some contribution.

Other Evidence

Statistics, however, can provide no adequate picture of what the contributions go for. Figures can convey no conception of what the varied aids from corporations actually accomplish. Most funds given help to support programs – colleges, for example – which get the bulk of financing from noncorporate sources. And some recipients in fact serve diverse groups – United Funds. Some companies give to dozens of programs of wide diversity. The lists differ.

Published accounts of the programs of some corporations and industry groups do provide varying amounts of detail about what is being undertaken. Case-study reports provide revealing accounts of efforts and accomplishments. Such material can put flesh on what would be a bare skeleton of figures. Impressions in human terms yield meanings essential for an adequate evaluation. Yet interpretation and evaluation are not easy. Sometimes one may identify a brilliant success, a moderately good result, and a failure. But, usually, qualitative judgments, secure as they seem in specific cases, have only limited applicability for general policy conclusions. Getting things in proper perspective may always seem difficult, especially for "outsiders" – and members of Congress, like all the rest of us, must *always* be outsiders for virtually *all* of what nonprofit organizations do in a country of the size and diversity of ours. One argument for pluralism as against government programs is that more opportunities will exist for evaluation, as well as for financing.

Among the many results which will always be difficult to judge by the case-study approach, as well as dollars alone, are those from corporate gifts to organizations that also get funds from other sources – universities, cultural programs, Community Funds, and so on. Attempting to evaluate the differences made by business giving will present endless challenges.[28] Some of the results intended can come only after several years; short-term evaluations, therefore, will be incomplete.

The problem of judging results calls for more comment.

Judging Results

Donor concern about what is accomplished from present giving appears in at least some companies. And managers who are urged to allocate more funds for philanthropy will want to be able to evaluate results. An increase in giving of magnitudes desirable from some points of view will add to legitimate concern about the alternatives and possibilities for worthwhile uses of funds. Companies and industries expanding their contributions from modest to more substantial amounts will sometimes wish to take a more active part in judging what the outlays accomplish.

The appraisal of individual programs should involve (1) the quality of execution and performance, that is, the efficiency of operations, and (2) the worth of what the activity does, that is, the merits of the accomplishments. A well-run nonprofit organization may serve ends that by reasonable standards are of no solid value (per dollar of expenditure). And an inefficiently managed program may achieve results of great worth. Corporate contributions officers need to be alert to each of these parts of the total job of evaluation. Businesses can do more than make the guidance of their own funds more fruitful. Because of corporate leadership, the gifts of individuals and other companies can also serve to better advantage.

No competitive market tests the worth of results of philanthropic activities. Donors cannot count on objective and impersonal measures to evaluate the accomplishments of individual programs and to compare them in allocating funds in the future. Among the problems is a difficulty that seems inherent: the managers and boards of the recipient agencies will often be less than fully objective; they will frequently want more for their agency. Yet as the persons closest to the actual operations of an organization they will possess some kinds of competence, experience, and familiarity needed for judging accomplishments and which can be found nowhere else.

The beneficiaries of nonprofit organizations may, or may not, be aware of receiving help. Often the financing is indirect and grouped so that numerous donors are in fact responsible. The absence of any consideration of quid pro quo separates recipients from any challenge to try to decide what the program is really worth.

In some cases, youth programs, for example, an important fraction of the benefits hoped for can come only in the years ahead.[29] Intangibles, of course, make up some of the objectives sought. Corporate donors, for example, may be seeking improvement in the climate in which business operations are to be carried on. Many aspects and facets go to make up the climate for business. The contributions program may accomplish more than a little and yet be outweighed by other things. Judging what would have developed if contributions programs had been different in emphasis, or larger or smaller, will in most cases be tentative at best.[30]

V

INCREASING CORPORATE CONTRIBUTIONS

What methods of encouraging corporate contributions might be considered? What factors will tend to favor, and which to hamper, business philanthropy?

How Much Might be Expected?

Are there general standards to indicate the "proper" amount for an individual company – or an industry – to contribute? Are there criteria for setting a goal for the total amount the business world "ought" to be expected to donate?

No basis for prescribing general standards seems reasonable – no amount related to earnings, total sales, value added, profit as a percentage of investment, assets, employment, community conditions, industry structure, or some other. Diversity is so large that standards appropriate for one, by any set of criteria, would be inappropriate for others. The very essence of voluntarism leads one to expect – and to support – considerable differences, including toleration for what may seem to be shirking. Responsibility rests with individual managements.

However, expectations of appreciable increases in corporation giving do seem reasonable. Cannot more of the corporate world move toward practices of the leaders? For many companies it must be not a lack of ability but of conviction that is keeping gifts low. Beliefs about what is "right" can be deliberately influenced. Anyone trying to induce managements to contribute more should, it seems, focus on the benefits to business. Much as an advocate may be sensitive to the condition of recipients, it is the long-run advantage of the donor company that should govern its contributions decisions.

Forthright efforts to raise expectations about what businesses ought to give may be defended on the grounds that pressure on business firms to do more, in quantity and quality, will inspire responses that *do* achieve more *from which the business* *world will benefit.* Yet resource limits *do* exist.[31] Outsiders cannot presume to be competent to judge how a corporation can best use its limited funds.

The language of advocacy may tend to raise unreasonably the hopes of potential beneficiaries. Some corporations *do* have "lots" of money compared with most of the agencies requesting aid. The funds that might seem to be available for contributions could "meet" the "needs" of *any* of many desirable programs. But not of all.

A responsible program of trying to increase coporate giving will try to keep hopes realistic. Disappointments can offset positive accomplishments – if more had been expected.[32]

To the extent that the goal of business giving is a better "climate" for enterprise – an "environment" in which business can function more effectively – varied public attitudes and intangibles are involved.

For some desirable things, no end to requests for funds will come naturally. A generation, or even a decade, ago one might have thought that "social" outlays of government at the present scale (adjusted for changes in the value of the dollar) would have done far more to "solve" problems than seems to be the case. Corporations must not be expected to "fill" all the "gaps" remaining. Yet because business does produce demonstrably improving results – in output and employment and product innovation – many of us naturally look to it for things we seek outside of the normal activities of the market place.

Rising aspirations create targets that are moving. Note that one set of parties expects *gifts* – to receive without returning an equivalent. For this reason, keeping expectations within reasonable limits may call for special attention. The situation can become especially delicate when the donor tells itself and the public (and the shareholders), "This giving is good for *us* as well as for the recipients." Beyond some point, however, alternative uses of a corporation's funds must be better. Where benefits are not short-run, judgment of what is best to do now becomes even more difficult.

A brief listing will indicate some factors which will properly make for differences in expectations and in practices. Local conditions, needs, and resources vary. The role of government (and hence the role for *nongovernmental* agencies) is not the same everywhere. For example, more of higher education is financed by governments in some places than in others. The amount accomplished in the past differs; among the conditions that will vary as a result will be the demands for capital building. Some programs if successful should reduce the need for their very existence. Some companies have the resources, as well as the desire to take a longer view, and to sacrifice more at present for the future, than will others. Differences in competitive pressures affect the ability to incur costs that do not currently bring tangible benefits. Moreover, when intangibles are as important as they are for much of philanthropy, managements' views about what will produce worthwhile results cannot be expected to fall into anything approximating a uniform pattern. Company accountings differ. Some outlays classed as business expenses by one corporation will be treated as contributions by others. The roles of nonmonetary aids differ.

Specific drives and annual programs do at times involve quotas; community leaders may agree on criteria for giving by individual companies. Reasonable compromises may be reached from year to year. But the very nature of voluntarism and diversity will restrict the scope of such guidance. Neither federal tax legislating nor other governmental processes can claim competence for determining quotas for company giving.[33]

Having noted why no single goal seems logical and why care is needed to avoid raising unreasonable expectations, is there still more to be said? Nothing found in making this study has suggested that leading corporations are so disappointed with results to date as to plan a material cut in total donations (as a percentage of earnings).

For the corporate world as a whole, some appreciable jump above the recent average of a little over 1 percent of net earnings ought to be possible. So many companies do little or nothing. Over one third of 1970 net income (35.1 percent) was earned by corporations giving nothing or under 0.2 percent. More than one fifth (22.7 percent) of income was earned by corporations that contributed from 0.2 percent to 0.6 percent. Cannot at least half of these companies be induced to approximate the average? And those now in the lead to raise their own "norms"?

Profitability of Business

A major factor will be profits. The historical record confirms *a priori* reasoning in supporting this conclusion. From company to company, of course, there is no fixed relation between profits and contributions. But for the business world as a whole, year in and year out, the *level*, and probably also the trend, of profits will have much indeed to do with contributions. The philanthropy of owners of unincorporated firms will also depend significantly upon the prosperity of their companies.

Professor Nelson's analysis of the historical record found a rate of increase greater than that of profit growth alone. Philanthropies can expect to benefit from something of a cumulative byproduct effect of rising profits. The amount that some corporations contribute depends in part upon what others are giving. An increase in profits which helps to raise the contribution level of some companies will lead others to follow suit. A combination of (1) greater economic ability in the form of higher profit for business generally and (2) the example of some of some corporations – the working of what economists call a "demonstration effect" – will produce a bigger increase in total giving than profit growth alone would lead one to expect.

Conversely, other things being the same, laggard profits will depress contributions. For many years real corporate earnings (adjusting for the decline in the purchasing power of the dollar) have been discouraging. The full realities of actual profit results, such as the inadequacy of depreciation based on original cost, have not always been recognized. What the full facts of the past may signify for near-term corporate philanthropy is not at all clear. Nor is the longer-run outlook for profit one for confidence in amounts or trends of *real* earnings.

Possibilities of Government Action

Raising the 5 Percent Limit

Corporations responsible for substantial amounts of giving do reach the ceiling, at least occasionally. One concludes, therefore, that the ceiling does exert some restrictive effect. Raising the 5 percent limit would presumably lead to some increase in contributions.

The ceiling might be eliminated entirely; it is an anomaly with little or nothing to justify it. If there is to be any limit, it might more logically be related to sales, value added, purchases, payroll, number of employees, or perhaps some other measure. In principle, however, the notion of any ceiling at all is so unreasonable that reform efforts should probably be devoted to making the existing form as harmless as possible.

Deduction of More Than the Amount of the Contribution

One possibility would be to permit corporations to deduct more than the amount of the contribution itself – perhaps 150 percent, or more or less.

Such a provision might be questioned on general policy grounds. In strong justification, however, one would cite the positive externalities from philanthropy. Benefits beyond those for the donor are expected. An extra element of government assistance can be supported as a means of encouraging actions that yield broad benefits greater than those of normal market transactions. Government could aid the many direct beneficiaries of contributions and in addition all those of the community who are better off because of the programs of nonprofit organizations.

Increasing the Value of Deduction by Corporations Not Subject to 48 Percent Rate

Corporations with $25,000 or less of earnings might be permitted to deduct an amount which in tax terms would be equivalent to the deduction from income of amounts subject to the 48 percent tax rate. (Before 1975 that rate applied to corporations with incomes over $25,000; the rate now applies to corporations with income of over $50,000.) Most corporations, of course, could benefit. It could be said that the higher rate of deduction would put them more nearly on a parity with larger corporations. Such considerations of equality among corporations, however, would be of quite secondary importance compared with the major feature – an increase in tax reduction when contributions are made.

No obvious reason appears to justify cutting big corporations out of plans to stimulate giving, if such is the goal. If the objective is to encourage more businesses to contribute, and in larger amounts, then allowing all corporations deductions that in fact are at 48 percent (or the rate applying to large corporations) may seem to be a reasonable first step. But if the rationale is that contributions are properly expenses of business that will be of long-run benefit to the enterprise, the present apparent lack of symmetry may seem to be defensible. The earnings–benefit eventually received will in most corporations be taxed at the lower rate only. However, if the business is successful and grows, then some of the eventual benefits in earnings may be taxed at the 48 percent rate. The present lack of symmetry does perhaps discriminate against some growing firms. Deduction at a rate above 22 percent could be justified. Yet there is disadvantage in adding complications in the tax law.

Tax Credit

The worth of contributions to the donor could be enlarged by converting the deduction into a tax credit. Instead of deductibility which reduces tax by 22 or 48 cents contributed for each dollar (somewhat more when state income taxes apply), a portion of total contributions could be allowed as a credit against tax – dollar for dollar perhaps. The entire amount of gifts up to some limit might be credited against tax. Comparable provisions might be allowed to unincorporated businesses, subject to restrictions. Conceivably, some types of gifts could be favored as against others.

The arithmetic of corporate giving could certainly be changed to make such uses of business funds relatively more attractive than at present. Contributions not now qualifying on the basis of probable advantages to the corporation would become justified. Depending upon the terms of the credit, the effects of changing from deduction could be modest or large. A dollar-for-dollar tax credit would make qualifying contributions "costless" to the company. Smaller credits, but larger in fact than the effects of the present deductions, [illegible] be provided. A tax credit could assure big increases in giving. A plan that stimulated giving would raise the cost to government, but some offsets might eventuate in the form of lessened demand for governmental aid and in advantages to the general public. Any assistance for business earnings in later years would raise tax revenues. But such possibilities are not solid enough for substantiating a change in tax law.

Complications would arise in distinguishing between contributions and business expenses. Valuing the efforts of executives and other staff and gifts in kind would add complexities and give rise to new sources of dispute.

Establishing a Contributions Floor

A major departure would follow from a suggestion patterned upon the provision of the personal income tax affecting the deduction of medical expense and casualty losses.[34] No deduction might be allowed for contributions of, say, the first 0.5 or 0.9 or 1.0 percent or even larger percentage of earnings (or some other measure). Amounts in excess would then be deducted, perhaps as are other business expenses (dollar for dollar) or in some larger amount (150 percent or 200 percent of the gift) or allowed as a credit against tax. (Refer to findings of Conference Board survey.)

Such a plan could be structured to provide a considerable stimulus for at least some corporations. Amounts above customary giving (conceived in some more or less arbitrary manner) could be encouraged by providing large leverage. For example, if corporations have generally been giving around 1 percent of earnings, that practice shows a willingness to make gifts in this range under existing conditions of profitability, tax deductibility, and belief about desirability of use. If no deduction (or only half or some other fraction) were permitted for this amount but a tax credit or deduction of, say, twice the amount of contributions *above* 1 percent were allowed, then some corporations would probably step up contributions.

Some combination of terms could be devised to stimulate giving but with relatively limited revenue effect. A denial of deduction for most of present level of giving coupled with much enlarged tax benefit for amounts above the level could change behavior. The reactions could not, of course, be predicted with certainty. There could also be terms which would materially discourage giving – a floor of 3 percent and deduction only for amounts above.

A structure which would be reasonably certain to encourage contributions could represent a form of compulsion. There would be denial of allowance for deductions that are in fact "expenses" of the corporation's operations intended (or serving) to enable it to exist as an enterprise and to prosper through the years. Such governmental intrusion into management decisions seems unlikely to improve the society.

The pursuit of one objective, encouraging contributions, would be at the sacrifice of "proper" treatment of expenses of running a business in the modern world. The reasons noted earlier for recognizing contributions as expenses made to benefit the company – some time and in some way – argue compellingly for allowing the deduction of all contributions.

Many complications would arise. The distinction between gifts and business expenses would take on new meaning. Contributions in kind, especially staff time, would present problems of administration and compliance.

Adjustments for Industries and Companies That Differ From the Average

Utilities. Regulated public utilities are in some cases not allowed to treat contributions as expenses allowable for purposes of rate-making. Such conditions could be changed. State rules rather more than federal rules are involved. Giving could be encouraged by modifying law and the administration of rules applying to the utility industry to make them conform to the more general practice.

Certain life insurance companies. Some life insurance companies taxed under separate provisions do not in fact receive a reduction of tax for their contributions.[35] Without altering the established methods of taxing the income of insurance companies, Congress could provide for tax reduction equivalent to that of other corporations. Life insurance companies could, for example, be permitted to credit against tax the amount of the company's contributions multiplied by 48 percent, the tax rate generally applicable at the margin to the earnings of large corporations. Such treatment could stimulate giving, but evidence for suggesting amounts does not exist. The rationale for such action would be a desire to encourage giving.

Loss corporations. Some corporations incur loss for a considerable period. Their contributions may not now be fully deducted against earnings during the years of carryover. They might be given cash payments from the Treasury. What amount might be appropriate? Presumably, it would be the gifts multiplied by an assumed tax rate – 22 percent or 48 percent. An estimate of the worth of the contribution to the general public would in principle be defensible – but in fact not determinable.

The rationale for some provision of this sort would be to encourage both declining and relatively stagnant, and struggling and growing, corporations to make gifts which have an element of public benefit. Most companies presumably hope to become profitable and thereby able to use the normal carryover. But all would know that if profit did not eventuate, the donations would "yield" some return of tax. One risk of giving would be reduced somewhat. For the public the benefits from the gifts would, it is hoped, be great enough to justify the cost of the unusual tax treatment.

Valuation of Gifts from Inventory

One out of three chief executives of corporations reporting in the Conference Board survey said that reestablishing deductibility at fair market value (as before 1969) would lead to an increase in giving.

Actions in the Private Sector

If corporate giving is to be increased by more than the normal development of forces already in existence, what actions in the private sector can operate? The discussion here will not attempt to cover fund raising, in itself a highly developed activity.

The Commission's own activities represent a noteworthy example of actions predominantly in the private sector. Some or much of the practical impetus for implementing changes in the tax law as suggested above would presumably come from outside the various branches of government. Although discussions of action on a broad (national) scale frequently seem to assume that government is involved, the role of private groups will often be much more important. Typically, as is especially true in connection with nonprofit activities, the things being done are widely dispersed – geographically, of course, but also by interest and by function. The many phases of the Commission's own work testify to the variety.

Whatever government does, and if no tax or other changes are made, the future of corporate contributions will be influenced substantially by private leadership. Some will emerge from the side of nonprofit agencies and approach donors with presentations of needs. In other cases new energies and leadership can come from the business world. The impetus may be a new awareness of need, perhaps some new challenge. Or a sense of success in some program may produce enthusiasm for additional efforts. The focus and methods of operation will reflect, among other things, both the diversity of the country and the values of voluntarism. Perhaps the only generalization that can be made with confidence is that much will depend upon the qualities of leadership.

One source of initiative which deserves explicit mention will appear within some corporations. Some companies are now examining existing practices and formulating alternatives to be considered. Presumably, expansions of giving will result. Innovations can be expected. The examples of some corporations will bring responses from others, especially if good results appear.

Footnotes

1. This conclusion from a special Treasury tabulation strikes the author as improbable. Some corporations apparently deduct gifts to United Funds and other philanthropies as business expenses, not contributions. For tax purposes, neither the Treasury nor the company may in practice have any concern about how some deduction outlays are classified.

2. The figure shown is an estimate subject to a wide margin of error. We do not know how much corporations gave in 1974 and so can only guess about an order of magnitude as to a possible increase.

3. Net benefit would result only when the fruits of such spending are more valuable than would be those of the alternatives sacrificed. The fact that the funds and staff effort are not used in other ways means, of course, that other things are not obtained. Rarely would there be any way to know what other desirable ends were sacrificed, chiefly, of course, by the corporation (and some by shareholders). When business gifts are as low as at present in relation to company affairs, the concern for the cost in sacrificed alternatives will be slight. More questioning would be called for if giving were to rise markedly.

4. Laws may discourage giving in the sense that reasonable (as against substantial) changes would assist contributions. In some states, for example, the regulations governing public utilities deny the treatment of donations as expenses in determining rates. Federal tax laws governing the valuations used in deducting gifts of tangible property from inventory are stricter than at one time. But the gifts can be made.

5. The Conference Board's Study for the Commission on Private Philanthropy and Public Needs, "Corporate Philanthropic Public Service Activities," presents data on staff involvement in philanthropic activity.

6. An extensive study by the Committee for Economic Development explored some aspects of the term.

7. The point here is not by any means to imply that social responsibility is absent or irrelevant. Rather, thinking about corporate contributions can be clearer if guided by less imprecise terms.

8. Membership fees and support for various organizations may be deducted as business expenses rather than as contributions. Practice varies. Although a corporation may have no fixed amounts for the total of both kinds of outlays, limits will exist.

9. The term "society" is apparently assumed to mean an entity rather than individuals. Yet human beings, people, do whatever is done. All thinking is done by *individual* minds. And groups consist of individuals.

10. The order of listing of arguments is not intended to suggest relative importance.

11. The picture of a dictatorial officer using company funds to impose his will on others, though imaginable, appears only rarely in writings reviewed for this study. Legislators voting government funds, and civil servants exercising discretion, may also exert "dictatorial" influence. The involvement of government may appear to convey legitimacy – election does have meaning – but results are not assuredly wise or even a reflection of majority view. Occasionally, a nonprofit organization may be subject to considerable influence from a large donor. Conditions attached to gifts may reflect the preferences of a corporate official or group. This possibility relates to the one-sidedness of a gift; there is no quid pro quo, and the recipient has a dependence which may create a sort of vulnerability.

12. Large corporations can afford to staff some activities, such as participation in nonprofit affairs, which are apart from the main elements of business. Most firms do not have such leeway. The time of their top officers and employees devoted to philanthropic projects will be at the expense of the company's primary tasks.

13. At this point it may be wise to remind the reader that these varied arguments may warrant attention and have some merit and yet not by any means carry enough weight to be decisive.

14. See Conference Board study, op. cit.

15. The support paid for by corporate contributions can also yield benefits to individuals which few will appreciate. Although employees, suppliers of capital, and customers are expected to benefit as individuals from a larger element of voluntarism and less of coercion, is the use of corporation funds to advance even the general interests of individuals (beyond those of the company) justified? In principle, it is said, individuals ought to finance their personal investment in voluntarism out of their own incomes. Many do so without an explicit awareness of the reasoning here. Yet the social philosophy which values highly freedom and voluntarism may not in fact be widely understood and appreciated, even intuitively. Individual financial sacrifices to advance it "adequately" cannot be counted upon.

16. The Economic Development Council in New York City provides an example.

17. Not all staff loaned by corporations to nonprofit organizations will have exceptional capacities and strong motivation for making an unusual improvement. Many problems arise when businesses provide personnel on a temporary basis, especially if the persons involved do not possess high capability and motivation. The potential summarized in the text is not an unrealizable dream. But corporations are not surfeited with high quality personnel who can easily be released or whom they may be willing to release on loan to an outside organization.

18. Do we not, however, sense a tendency, perhaps partly unconscious, to disparage self-interest, especially to big business and even if "enlightened"? Does it cast something of a cloud on efforts of corporate decision makers to get favorable public-opinion results from contributions? Persons, *e.g.*, college students, who support self-interest on the part of nonprofit organizations and their clientele, may criticize efforts on the part of donors to relate gifts to results in attitudes toward the donor – "buyer favor." Be that as it may, corporate managements in allocating the contributions budget will properly look to what the different possibilities appear likely to achieve for the company in public recognition.

19. Some writers suggest that philanthropy is a form of personal consumption which brings satisfaction to the donor; to some extent, in some cases, plausibility does attach to the argument. But should the tax laws, then, treat such uses of funds no differently from a donor's spending on his family? Who could possibly know which personal philanthropic uses of funds are designed to benefit the donor? Human beings must differ enormously in this range of feelings. Do such motivations apply extensively or negligibly? What would be the effects of implementing such a change on, for example, colleges and cultural activities?

20. The discussion here ignores loss businesses. Deduction of donations in loss years saves no tax. Companies that do not have taxable earnings later, while carryover of gifts is possible, never receive any tax relief.

21. See also Ralph Nelson's report to the Commission on Private Philanthropy and Public Needs, "Private Giving in the American Economy: 1960-1972."

22. See Conference Board study, op. cit.

23. Ralph Nelson, *Economic Facts in the Growth of Corporation Giving*, p. 66.

24. Rounding puts all amounts under $500 at zero. Therefore, it is difficult to interpret the showing for the 228,493 corporations who made gifts of less than $500 each, but for which the table shows zeroes.

25. Some of the deduction in 1970 may have been carryovers from earlier years when gifts exceeded the amount allowable. Some corporations will have established practices and perhaps made commitments so that gifts were sustained in 1970 (a year of recession) despite a drop in earnings. A continuation of low profits would perhaps, or probably, lead to a decline in gifts that do not qualify for income tax deduction.

26. Companies of largest size account for largest dollar amounts but generally give under rather than over 1% of net income. If even a few of the biggest corporations gave around, say, 3% of income, the dollar amounts would swamp the other figures and change the averages. For example, if only one corporation with $1 billion of earnings gave 3.1%, its giving would be $31 million. The total for all of the corporations making gifts of from 3% to 4% of income was around $68 million.

27. The comparisons here do not cover life insurance companies. They are subject to special tax rules which, among other things, may in effect deny them deduction for contributions.

28. Individual corporations putting funds into United Way compaigns will not have opportunity to get public credit for any specific results of one or more of the constituent agencies. This condition may cause no concern. But anyone asking for enlargement of corporate giving should bear this fact in mind.

29. Judging their present worth, i.e., the extent to which sacrifices are justified today, will require, not only evaluations of results as they appear in the future, but also the application of a rate of discount. Such sophistication is hardly to be expected in a rough and ready way.

30. Casual observation suggests that public attitudes toward businesses generally have not improved in recent years when contributions have increased. Agencies seeking funds and implying use of the argument that business climate will benefit may have some obligation to try to convert the possibility into reality. Perhaps Commission members associated with recipient programs can suggest ways to make corporate contributions more fruitful for donors.

31. If a corporation must spend large amounts on anti-pollution equipment or meeting safety requirements or training poorly educated employees — all to meet what are designated as social responsibilities but outlays that do not produce salable output — then it may be less able to contribute as much as it would like to philanthropies.

32. Assertions such as in this section are perhaps superfluous. Commission members will hardly need to be reminded, but other readers might be less aware of the sensitivities and intangibles.

33. Rules established by government are at times desirable to clarify what each company must, and must not, do — for example, defining the requirements for reducing pollution and meeting safety standards. Compulsion can put all companies on a basis of competitive equality. Philanthropy, however, does not fall in this class.

34. The reasons for the two personal income tax provisions differ from those proposed for corporate gifts. For casualty losses the $100 figure serves to eliminate small amounts which are difficult to check and which can be considered as a normal risk of life. The medical limit has been justified as amounts that can properly be borne as more or less normal elements of personal budgeting.

35. For certain life insurance companies, federal income tax is based on investment income. Some of them and other financial institutions make "contributions" in the form of loans at below-market rates. They are not taxed on the interest sacrificed – but get no tax benefit. Gifts of cash by insurance companies, and the expenses of time of personnel and facilities made available, are not recognized in the computation of tax.

CORPORATE CHARITABLE CONTRIBUTIONS AND CORPORATE SOCIAL RESPONSIBILITY

Milton Moskowitz[†]

What role does philanthropy have in the corporate response to social problems? Has corporate giving changed much since 1968, when the modern movement of corporate social responsibility began? What can be done to make corporate philanthropy a more effective instrument for social change?

In assessing corporate philanthropy from this vantage point, we are immediately confronted with a paradox, which is simply this: Many people who are closely identified with corporate social responsibility, either as participants or observers, recoil at the term "philanthropy" and consider it at best inappropriate, or at worst inimical, as a rubric for corporate social responsibility efforts. The reasons for this hostility are clear. Efforts to reform corporations or change business practices have concentrated on corporate behavior as reflected in day-to-day, ongoing activities. The objective has been to make the corporate animal a socially responsible creature. To zero in on philanthropy and neglect the basic operations of companies is to beg the question of corporate social responsbility.

In their book, *Private Management and Public Policy* (Prentice Hall, 1975), Lee E. Preston and James E. Post noted:

> The modern form of corporate philanthropy derives directly from the strong ethical and religious concerns of some of the "robber barons," men who accumulated fortunes—not always through morally acceptable means—during the rapid industrialization of the late nineteenth century. . .
>
> From its scattered and highly individualistic beginnings, the idea of corporate philanthropy became accepted over the following decades as a routine managerial activity, institutionalized particularly in the community chest movement.

The idea expressed here—that philanthropy is really extraneous to how a business makes its money and survives—is what makes advocates of corporate social responsibility uncomfortable about philanthropy. Almsgiving is not what corporate social responsibility is about. Consider the comments made by Theodore L. Cross in *Black Capitalism: Strategy for Business in the Ghetto* (Atheneum, 1969):

> In too many cases companies are simply donating jobs—like contributions to the United Fund—to buy peace in the ghetto. Jobs for hard-core unemployables are an improvement over "care packages." But when they are handed out like welfare, or as "reparations" for discrimination of the past, whose needs are being satisfied—those of the businessman who likes to feel he is "doing his part" or the needs of the impoverished, untrained black? The "Jobs Now" programs of the National Alliance of Businessmen finally buries the black nationalist argument of employer discrimination which has shut out the Negro from our economy for a hundred years; yet who needs to bury this argument—we or they?

The point made here is that charity, even when it takes the form of jobs, benefits the giver more than the receiver. It is, in short, "conscience money." Those who have worked within corporations to fashion social programs and social philosophies are keenly aware of the shortcomings of a philanthropic approach. In an interview in 1971 with John Brennan, then public affairs manager of the Re-entry and Environmental Systems division of General Electric, he noted that "The days of handing over a $50 check, having your picture taken with some community leader, then running behind the protective corporate walls, are gone—hopefully forever. Money alone is not merely meaningless, it's negative. Organizations which donate money and don't help to solve the problems will be accused of buying their way out."

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What Brennan and other corporate public affairs officers were saying is that any attempt to subsume social responsibility under the heading of "philanthropy" is bound to fail and boomerang. This was expressed most succinctly in 1971 by Phillip T. Drotning, who manages the corporate social responsibility programs at Standard Oil Company (Indiana). Reviewing in *Business & Society* the evolution of the corporate social responsibility concept, Drotning said:

> At the outset, most companies developed social programs, largely in the urban racial area, as an extension of traditional support for charitable endeavors. As a consequence, social expenditures were largely applied to the symptoms of public problems, but had little impact on causes. They represented minimal actual involvement of the corporate organization in social problem-solving.
>
> As the appalling ineffectiveness of most of this effort became clear, recognition developed that if corporations were to develop significant programs in social areas, they must be integrated into normal business operations, not treated as a separate and often ephemeral responsibility.

The message here must not be misread. Corporate philanthropy was not seen as the route to social responsibility. What is worse, it was deemed a dodge. Robert C. Gunness, vice chairman of Standard Oil Company (Indiana), delivered essentially the same message in an article he wrote in 1974 for *Business and Society Review:* "Much socially responsible corporate behavior has been simply an extension or redirection of traditional corporate programs in our philanthropic and community relations programs. . . The business response, in short, had little to do with corporate behavior, with the way we ran the company. The primary thrust was to seek new ways to spend money—but not too much—to support the problem-solving efforts of others."

This derogation of the philanthropic component of corporate social responsibility continues to the present time. In an article in the July-August 1975 issue of the *Harvard Business Review,* Kenneth D. Walters, assistant professor of business, government, and society at the University of Washington, states the case as follows: "Too often social responsibility is seen as being limited to corporate gifts to charity parceled out by top management and the board of directors. But the organization's interface with society is far more complex than this, and employees at all levels have a stake in the organization's social performance."

Even more telling are examples from the casebook file of two major corporations. In 1972, IBM introduced an innovative program called the "Fund for Community Service." This program was designed to answer some of the traditional complaints about corporate giving, namely, that it is often dominated by headquarters office considerations and that it is frequently ensnarled in a thicket of red tape. IBM's community service fund works this way: Employees who are active in a community project may apply to the company for financial support of the project; to do so, they need only to write a brief description of the project and the sponsoring organization. To gain release of the funds, only two approvals are required—that of the employee's supervisor and one other IBM executive. There is no upper limit on these grants, but in practice they have averaged $700 per project.

In the first two years of operation, the IBM fund disbursed more than $1.6 million for 2,255 different projects in scores of communities across the nation. The significant aspect of the program that concerns us here is that it is not lodged in the gular charitable contributions area. It is, in fact, administered by IBM's personnel epartment. And the allocations were not included as part of the $17.7 million that 3M reported as its charitable contributions in 1973.

In a similar category is the innovative training program for school principals that hase Manhattan Bank helped to fund in 1971. This was a two-year program in hich the principals of 12 elementary schools in the New York City area were ought together in a series of conferences and workshops to deal with the issues cing an urban school system. The aim was to involve the principals as leaders in e development of solutions. In embarking on this project, Chase decided to chew the traditional grant approach. Support funds were appropriated as normal erating expenditures. In fact, they became line items on the budget of a rticular officer who was then made accountable for the results. Benjamin Roter, a ce president of Chase, pointed out that "this level of involvement ensured the nk that its investment was being managed from within, and conveyed the fact at Chase was making a protractive commitment that went beyond the customary actice of corporate giving."

These twin examples testify forcefully to the uneasiness that corporate executives el about charitable contributions. IBM and Chase relieved their uneasiness by moving these contributions from the charitable contributions bailiwick. They viously felt that such a move would make these contributions more productive. hat tells us a lot about how the charity dollar is perceived, even by sophisticated rporate givers.

These examples also bring us to a consideration of the legitimacy of the rporate charitable contribution. Other papers have dealt at length with the legal isis of corporate giving, and I only want to underline here what corporate ecutives have told me, which is that companies make contributions because they lieve that it is in their selfish interest to do so. Even critics of the corporate social sponsibility movement, such as the University of Chicago economist, Milton iedman, do not object to charitable contributions or corporate social programs so ng as the companies involved attribute these actions to the need to take steps to sure the viability or survival of the enterprise. What Professor Friedman finds jectionable is the corporate hypocrisy that attributes these actions to a selfless sire to improve the lot of mankind. That self-interest is the motivating factor was elled out lucidly in a penetrating article that appeared in 1970 in the *Boston niversity Law Review.* The article was written by one of the most astute observers the corporate social responsibility scene, Phillip I. Blumberg, now dean of the w school at the University of Connecticut. He concluded:

> Corporate activity in the social sphere is not, in fact, altruistic. It does not represent a purely voluntary and gratuitous act of generosity. It does not reflect a partial transmutation of the corporation into an instrument of social progress. It reflects a tactical judgment as to the most advantageous manner for the corporation to conduct its business in the light of the climate of opinion in which it must function. . .
>
> Fulfillment of business objectives is the ultimate standard as vital today as a century ago, when an English court upheld loss payments by an insurance company in a celebrated explosion disaster damaging 81 houses although the policy expressly excluded liability. . .
>
> . . .widespread unemployment in the early thirties created needs that threatened to overwhelm the private charitable agencies struggling to assist the victims of a depressed economy and created a climate where corporate contributions to Community Chest and American Red Cross drives became generally regarded not only as a proper, but as an essential, element of business operation. . .

> The depth of social needs molds both public opinion and the opinion of corporate managers on what constitutes 'good business,' and thereby in a sense may be said to create the basis for corporate power to deal with these needs.

The thesis that charitable contributions simply represent "good business" was also expressed, in more blunt terms, by George Spater, former chairman of American Airlines. Writing in the *Saturday Review* in 1970, Spater put it this way: "There is a general belief that corporate benefactions must follow the taste of the head of the company, and I confess that I personally like the things we are doing. But I would hope that, if we did not do them, someone else would. I believe that what we are doing benefits our stockholders. It produces more interested, more creative employees. It benefits the communities in which we operate—the communities from which we derive our passenger and cargo traffic. It enhances our image among the tastemakers, the leaders of both our economic and our intellectual society. To use the crass commercial jargon of our industry, I believe it 'sells' tickets."

This sales justification of the corporate charity dollar by Spater is interesting in the light of subsequent developments at American Airlines. The company later admitted making illegal political contributions. Spater was forced to resign. And adverse economic conditions threw the airline so deeply into the red that not only were charitable contributions cut to the bone but the entire social responsibility function at American Airlines was eliminated. A cynic reflecting on the 1970 statement by Spater would find ample cause for decrying corporate charity as a cover-up for the irresponsible actions being taken by the company in its regular day-to-day operations. This will always be the case so long as corporate philanthropy is considered in isolation, as something apart from the grubby, money-making activities that make charity possible.

Companies frequently insist that they can't pursue or support social programs unless they do make money. This response betrays a complete lack of understanding of what the corporate social responsibility movement is all about. Corporate social responsibility is concerned with the entire apparatus of the corporation—what kind of products it makes, how it markets them, how it deals with its employees, how it treats its customers, whom it hires, where it locates its plants, what kind of role it plays in communities. To imply that these matters cannot be dealt with effectively—that a company cannot, for example, practice nondiscrimination in employment—until it makes what it considers an adequate return on investment does indeed cast corporate social responsibility as an act of charity, an afterthought—and this is probably the central reason why corporate philanthropy is regarded, both inside and outside the business community, as a "can of worms." Gulf Oil Corporation was far more generous to corrupt politicians in South Korea and Bolivia than it was to poor peoples' groups in its hometown of Pittsburgh. Why? Because the illegal payoffs abroad were considered vital to the protection of Gulf's assests; poverty-stricken Pittsburghers were not accorded that status. And there's no way, given the way corporate philanthropy is now administered, that this will change.

In interviews with 12 executives of some 10 major corporations, I gained a strong sense of how corporate philanthropy is administered. (Interviews were conducted in person and via telephone during June-July 1975.) Here's a capsule picture:

- It's the rare company that tries to be innovative in its charitable contributions program.
- Most of the corporate charity dollar is locked up or committed to traditional establishment groups—United Way, local hospitals, the Boy Scouts, the local symphony orchestera.
- Many corporations are very uneasy about their charity programs because they are subjected to various pressures, both from within the company and from without. This results in too many would-be recipients chasing too few dollars.

- In this situation, contributions officers often feel that they do not have control. As one of them said, "If we have four members of the board who are graduates of the Stanford Business School and Stanford is having a major fund drive, you know we are going to be hit."

- The single most important standard in determining how much money is allocated to charity is, What's the other guy doing?

- Corporate chiefs see no benefit in having the tax laws liberalized so that corporations could give more to charity without sacrificing profits.

- Corporate officers assigned to the contributions area meet regularly with their counterparts in other companies. The result is charity by consensus. They allocate along similar lines, in terms of deciding both what amount will be given and who will get what.

- It's the rare company that has any fresh ideas on how charitable contributions can be made more effective. When this question is asked, most executives have no ready answers. A typical attitude is the one voiced by Michael Roudnev, who is director of public affairs for Del Monte Corporation in San Francisco and who is charged with the major responsibility for company contributions: "If there were no tax incentives, we would do it anyway. . .If the tax incentives were fantastically liberalized, it wouldn't make us give more."

Roudnev explained that Del Monte considers charitable contributions "a cost of doing business. It's necessary for us, just as it's necessary for the individual." He added that one of the prime justifications for Del Monte's program is that the company recognizes that if it does not give voluntarily, the government would step in and do it. And Del Monte is not keen on governmental social efforts. One of the conditions of its giving is that no funds go to groups that have any funding from the federal government.

Roudnev also pointed out that one of the areas where the company has no control is the matching-gift program. It must match gifts to schools designated by employees, although it does consider this "a reward for schools which give us our employees." Roudnev said that he personally agrees with the views expressed recently by David Packard of Hewlett-Packard that companies ought not to give unrestricted grants to schools that inculcate anti-business attitudes. "No one likes to give a present at Christmastime to someone you hate," he noted.

Del Monte's giving is closely in line with the average for major industrial corporations—it allocates roughly 0.8 percent of pretax profits. How does it arrive at that percentage? Roudnev said, "Look, if we gave 3.4 percent then our stockholders would have a legitimate gripe. On the other hand, if we reduced it down to 0.4 percent then the community would complain that 'Del Monte doesn't care.'"

One company that takes its responsibilities in this area more seriously than most is the Weyerhaeuser Company of Tacoma, Wash. George Weyerhaeuser, president of the company, said that his company, like Del Monte, looks around to see what others are doing before deciding how much to give. But Weyerhaeuser Company, as befitting its position as the sales and profit leader of its industry, then seeks to play a leadership role. It consciously tries to excel here, as it does in its regular business operations. When the Weyerhaeuser Company Foundation was established 20 years ago, it had an annual budget of $100,000; it now dispenses nearly $3 million a year. Weyerhaeuser said the company works on a formula of 1 to 1.5 percent of pre-tax profits, which puts it above the average for all industrial corporations.

In the past few years Weyerhaeuser has revamped its giving program in recognition of the criticism that a disproportionate amount of company contributions were earmarked for its headquarters area. (This is one of the most common complaints made against conglomerates or other corporations with widespread holdings.) Today, regions outside the Tacoma area get 30 to 40 percent of the Weyerhaeuser charity dollar. Along with this move, Weyerhaeuser decentralized its decision-making process, establishing local review committees composed of employees, some of them rank-and-filers, to evaluate the allocation of funds.

In still another move designed to transform its giving into a more relevant instrument, Weyerhaeuser in 1974 set up a Venture Grant program that seeks "to promote the initiation, development and implementation of effective delivery system for the provision of educational, health and human services." Examples of contributions made under this program include a $75,000 grant to establish a skills development center in Plymouth, North Carolina, for low-income persons; a $116,000 grant to the Oregon Department of Education to develop new models for community participation in schools; and a $60,000 grant for the development of a film series designed to instill an environmental ethic in fifth- and sixth-grade students.

Weyerhaeuser is, of course, not alone in its efforts to innovate in the charitable contributions area. But its program, which George Weyerhaeuser describes as "doing our thing," remains the exception rather than the rule in the corporate world. More typical is the "boxtop" approach that has had national exposure under the aegis of Colgate-Palmolive Company. Since 1972 Colgate has been running a national advertising campaign in which it ties a charitable contribution made by the corporation to the votes of consumers. Colgate asks consumers to send in proofs of purchase of Colgate products and at the same time to indicate which of six organizations (including Boys Clubs, Girls Clubs, 4H Clubs) they would like to see receive a charitable contribution from Colgate (the latest sum available for allocation was $365,000). The company has touted this program as a shining example of corporate social responsibility.

An example of how a corporation can go beyond this pattern of giving to established organizations is provided by Syntex Corporation, the Palo Alto pharmaceutical manufacturer. Under the direction of Frank Koch, the company's public affairs director, Syntex has kept lines of communication—and funding—open to groups that do not normally get funded by the United Way. Syntex has done even more than pass out its own dollars. It has featured 20 organizations which do not enjoy high visibility in full-page advertisements in the local newspaper, describing the organization and suggesting that since it, Syntex, supports these organizations, others might also want to consider making contributions to them. The Syntex message in the ads: "These organizations handle a variety of community problems, creatively and constructively. That's why Syntex helps support them. . .Why not join us with your support, too? An investment in their work is, we think, a good investment in a better society. And we all profit from that."

If there is one corporation that best exemplifies how a business can make philanthropy an integral part of its operations, it is the Cummins Engine Company of Columbus, Indiana. This is not only because Cummins is one of the few companies that rigorously take the full 5 percent charitable deduction, year in and year out. It is the philosophy and content of its giving program that make it a model for emulation by those corporations that profess to be serious about their social responsibility concerns. (James A. Joseph, vice president of corporate action of Cummins, detailed this approach in an article in *Journal of Contemporary Business*, which is reproduced in the Appendix to this paper.)

Syntex's Frank Koch believes strongly that corporate philanthropy would be far more effective if managements would apply to this area the same disciplines they use to solve every-day business problems. "Corporations have no difficulty shifting funds internally," he says, "but setting hard priorities and evaluating the effectiveness of their contribution programs is another matter. It's time we treated corporate giving with the serious concern we give to the rest of our business—and why not? It has become an integral part of it."

Whether philanthropy has become an integral part of business operations is open to debate. I suspect that what Koch really means is that he *wishes* it were so—and that brings me back to the theme introduced earlier in this paper, which is that corporate giving remains a stepchild in the family of business.

As a stepchild, it is often ignored or dealt with summarily or treated in a manner different than the ways in which regular members of the family are treated. Businessmen are constantly parading before legislative committees, suggesting revisions in laws that affect them. One can count on the fingers of one hand the times leading businessmen have made serious proposals to change the laws and regulations governing charitable contributions. For them, it is simply not a matter of high priority. And as noted earlier, the advocates of corporate social responsibility realize how philanthropy is regarded in top management circles. This is why they bridle at having their programs assigned a "charity" label. They see this, probably correctly, as the kiss of death in the business world, as far as getting anything done goes.

There is a philosophical question that needs to be met here too. Poverty is as old as man—and so is charity. Down through the ages charity has, understandably, been resented by recipients, and this problem is still with us. If charity is seen as a handout from corporations which perpetuate poverty and discrimination, then it is not likely to become an effective social instrument. Those of us who have advocated social responsibility in the corporate world want to see the disadvantaged become part of the productive economy—as workers and even as owners of productive capital. We want to open up options for people—to create the conditions that will make philanthropy less and less necessary. In short, the objective of corporate charity should be to attack our social and economic problems so that charity is eliminated. That would tie it closely to social responsibility concerns.

Appendix

Corporate Philanthropy and Community Development: The Cummins Engine Company's Approach

James A. Joseph[†]

Introduction

No one who is seriously interested in the survival of American society and its cities can limit his (her) reflections about the responsibility of the business corporation to what is now called "social responsibility." For example, what a business does with its charitable deductions is important to the common good of the society, but the decision it makes about the location of a plant may make the difference between the life and death of a community. Therefore, this article is concerned not only with special corporate projects in the public sector, but also with the manner in which a corporation conducts its ordinary business in the private sector.

In the 1960's when the cities were burning and the poor were more visibly discontented, there was an apparent sense of urgency in corporate board rooms about saving cities. Business responded with a social responsibility movement which led to new community projects and the appointment of new corporate staff. But the projects were severely limited and the corporate appointments simply involved a few marginal people on the periphery of the corporation.

[†] Cummins Engine Company. Reprinted by permission of *The Journal of Contemporary Business*, Graduate School of Business Administration, University of Washington, Nancy L. Jacob, editor. Copyright Spring 1974.

Primarily, business was responding to the immediate demands of the social reformers. Far too much time was spent debating whether business has a *social* responsibility rather than institutionalizing a long-term process for fulfilling its *corporate* responsibility.

What a company does in the communities in which it operates must be seen within the context of what it perceives corporate responsibility to mean. When we were primarily a nation of farmers and merchants and the boss of each farm or store was the owner, the boss saw the primary corporate responsibility as that of producing goods and services. This pleased customers and, at the same time, rendered profit.

But today the business corporation is something far different. It influences the place where one lives, what one eats, what kind of air one breathes, the kind of water one drinks and the kind of product one buys. Therefore, it is only fitting and proper that new citizen groups suggest that the right of incorporation is a privileged status granted by government on behalf of the people — not simply a right to maximize profits as a self-serving economic institution, but one that enables the corporation to function in accordance with the well-being of society at large.

Corporate Responsibility as an Institutional Process

A company's ability to respond to society's problems depends on how it chooses to use its total resources. Institutionalizing corporate responsibility begins with an effort to define and bring into some sort of balance the responsibility to all who have a stake in a company's operation. These people include employees, customers, creditors, distributors, suppliers, governments, the communities in which the company does business, specialized publics (media, financial community, etc.) and shareholders. The responsibility to these stakeholders, which sometimes results in competing claims, should be considered in all decisions regarding expansion, acquisition, investments, new plant locations, new markets, response to social context, etc.

It is clear that one of the first steps toward fulfilling the responsibilities of business to its stakeholders is development of a process which provides formal direction to the company's efforts. To monitor and provide formal guidance in its efforts to be responsible, Cummins Engine Company set up a Corporate Action Division, headed by a vice president who reports directly to the president, sits on the management and policy committees and provides advice and counsel on all business decisions. The Corporate Action Division is divided into an internal and an external focus. The internal focus is directed by a department of corporate responsibility concerned with the responsibility to employees, shareholders, customers, suppliers and distributors. The external focus is directed by a department at Cummins which is concerned with the company's public responsibility to stakeholders outside of the company—communities in which it does business, the government, specialized publics and the society at large.

The Public Responsibility

In 1954 the directors of Cummins Engine Company decided to contribute up to 5 percent of domestic pretax profits to a separately incorporated foundation. In retrospect, the boldness of this effort was not simply in the decision to contribute up to the maximum deductible allowance; rather, it was in the willingness to support and develop nontraditional projects. The first of these occurred in 1958, the year in which the foundation's directors decided to devote its major resources to the improvement of local public education.

Cummins' concern with the relationship between educational environment and educational process led to a proposal to the local school board to develop an architectural support program. Since then, the offer was expanded to include other public buildings. As a result, Columbus, Indiana is a distinctly different community.

The foundation offers to pay the architect's fee for selected public buildings provided there is a willingness to accept one of a group of five architects recommended by an international panel of experts. The foundation has spent several million dollars in architectural fees and more than twenty buildings now have been designed.

As Cummins grew from an Indiana company to a national and then international company, it became necessary to re-examine the way in which philanthropy should be used to fulfill the responsibility to the broader society. The experience in Columbus demonstrated that in addition to providing maintenance grants to community charities, it also was possible to be innovative in a carefully defined program area.

Minority Community Development

Cummins' long-standing commitment to an egalitarian society led to the selection of minority community development as a major national focus. But we were determined to do more than simply copy past approaches; thus, we decided to design an approach based on what we knew about the social problems of the 1960's.

The first and most obvious problem which influenced our thinking was the state of powerlessness of minority communities. Support for efforts to build self-determined and self-controlled institutions seemed to be needed much more than human relations grants.

A second problem was the increasing obsolescence of national and local institutions and bureaucracies designed to meet citizen needs. Far too many institutions were operating as if their primary objective were to insure survival rather than to serve people.

A third problem was the failure of a pluralism which had been hierarchical rather than egalitarian. Minority groups were being asked to conform to those standards and practices which whites considered normative. Thus, the social change systems often were designed for minorities by whites rather than by minorities for minorities or by both groups working together to deal with common problems.

With this in mind, Cummins decided to divide philanthropy into two major areas – a corporate contributions program to support social priorities in the communities in which it does business and public responsibility grants aimed at special priorities of the society at large.

People and Power

The central thrust of the minority community development emphasis was on providing services as well as funds, making people available as well as grants. Like many other corporations, Cummins has been involved in release-time programs in which company personnel are available for a variety of social needs. Development of the Delta Enterprises in Mississippi was made possible through the loan of two company executives. Fine Vines, a subsidiary of the Delta Corporation, is now the largest black-owned manufacturing business in the South. But many economic development projects do not go far enough: There is a need in many communities not only for management skills, but also for people who balance social perception with social change experience.

The second aspect of our approach was hiring nontraditional staff. A study completed 2 years ago by the Russell Sage Foundation and the Foundation Library Center reveals some rather interesting information about foundation staff:

- Less than 500 of the 25,000 foundations in the United States had paid staff at the time of the study.
- Forty percent of all foundation staff were former college or university teachers.
- Twenty-five percent of all foundation staff came from college or other nonprofit administration.
- Thirty percent of the staff came from business administration, including accounting and banking.
- Less than 2 percent of total staff was black or other minorities.

The absence of minorities from corporate foundation staff or contributions committees often has resulted in the isolation of decision-making from direct contact with projects being evaluated in minority communities. This explains the tendency to dismiss many very good projects as separatist or "too militant." White staffs often fail to recognize that to be problack is not necessarily to be antiwhite.

The third aspect of our approach is one of empowerment. The Cummins Engine Foundation has five program officers operating in five major urban areas (one of whom also serves as director of community development programs). These officers were selected on the basis of experience and expertise in community development. Although they are high-powered and experienced community change agents, they do not seek to superimpose a grand design on the cities in which they operate. Rather, they assist and empower people in building their own institutions and in developing indigenous approaches based on the particularity of their own situation.

This approach does not lend itself to the clarity or the drama of the grand design, but in the long run, it is far more healthy and, we hope, far more effective. Community development program officers are *participant observers.* Because many foundation people are former academicians, it is not surprising that they tend to spend most of their time in their offices analyzing proposals. The Cummins Engine Foundation style is designed to be out where the problems are, where people are struggling against all sorts of odds.

The program officers are *servant-critics.* They are not simply out there to evaluate a proposal to determine whether it is good or bad; rather, they are there to assist people in making a good idea better. They are available as a community resource — not just as a foundation critic.

The program officers are also a *source of funds.* Each program officer has discretionary funds which can individually be called upon to support projects. We found that the key to our success is the ability to respond with immediacy — early enough to have a large multiplier effect and soon enough to keep a good idea alive. The program officer also works to find the larger resources needed to bring the idea to full fruition. Then, he (she) can submit a proposal to the Cummins Engine Foundation or decide to contact another foundation.

The program officers are also a *national resource.* Their services are available to staffed or nonstaffed foundations without charge, provided these foundations are in program areas of major concern. In addition, they continue to monitor and influence a wide variety of national and local organizations in minority communities. They were actively involved in the recent organization of the National Association of Black Foundation Executives, a group which is now available to the foundation and philanthropic community to provide some of the services formerly provided by the Cummins program officers. This organization (ABFE) has a data bank on people who are available to serve as trustees and staff for foundations and has a consulting team available to consult with foundations and corporations about program priorities. In addition, it is aggressively promoting equal employment practices in the foundation world.

The Philosophy of Grant-Making

The practice of making people available for technical assistance in community development should complement rather than replace grant-making. In an era when federal resources are being directed elsewhere and private foundations are still frightened by the Tax Reform Act of 1969, corporate contributions can play a very important role in influencing the future shape of the American society. But effective grant-making requires guidelines for determining priorities. A distinction should be made between consensus charity and creative philanthropy. Consensus charity involves support for the maintenance of the best of traditional service institutions and community charities. However, creative philanthropy refers to the support of new ideas and new projects on the basis of objective assessment of long-range priorities rather than as an attempt to cover the entire range of traditional philanthropic options.

My personal approach to evaluating projects in minority community development is based on the conclusion that inequities in the distribution of wealth and power in the American society provide the basic deterrent to social justice. Therefore, a grant should seek to facilitate the efforts of minoirty communities to acquire or influence the distribution of power. It should involve at least one of three basic approaches:

- Domesticating power — making bureaucracies more responsive to the needs of those citizens they are designed to serve.

- Democratizing power — forcing traditional institutions to share the goods of power.

- Developing power — supporting the development of indigenous power systems.

Domesticating Power

There is a tremendous need for support for efforts to establish a new relationship between bureaucrats and the citizens whom their agencies are designed to serve. The rebellion of welfare clients against the humiliation and insensitivity of the welfare system has been almost ignored by business. Yet this movement reflects an increasing rejection of the old strategy of rehabilitating the products of the system rather than reforming the process.

At any point in which a public institution grants an individual the power to say yes or no in a way that substantially affects another individual's life, that institution should be subservient to an independent authority for adjudication of complaints. This should apply to the welfare bureaucracy as well as the police system; it should apply to educational institutions as well as public housing authorities.

Michael Harrington was appropriately prophetic in suggesting that the clash between bureaucrat and citizen might come to be regarded as just as important to the common good for the country as was the clash of management and labor in the 1930's. But this is not to say (as some do) that centralization of functions is inherently bad. In fact, the major problem with federal efforts in many cases is not the result of too much power at the top, rather, it is the result of too little. For the black and other poor, the federal government often has been closer to them than city hall.

Making bureaucracy functional and responsive requires the support of programs that seek elimination of distant, insensitive structures which breed staff who are more interested in report content than in the quality of service. But domesticating power involves far more than an attempt to personalize bureaucracies. It remains for imaginative local groups to design programs and suggest approaches, but we must begin to sensitize our own management, boards of directors and, in some cases, the American public so that we can revitalize and humanize the social infrastructure needed to deliver community services.

Democratizing Power

Domesticating power will not be enough. We must move to democratize power, forcing traditional institutions to share the goods of power. Our educational, legal, economic and political institutions must be the primary targets of this strategy. It is increasingly clear that our educational institutions have been agents of social elitism rather than vehicles for democratizing the professions. Business has contributed heavily to education; however, it has had very little positive impact on the nature of the educational enterprise.

We have supported "credentialing agencies" in which individuals are granted the union card for economic success. As a result, we are now a credential society. One's educational level is often more important than what one can do. Young blacks, Chicanos and Puerto Ricans who are forced by economic immediacy to drop out of the educational enterprise cannot get jobs. Meanwhile, many companies which project an image of corporate responsibility continue to use culturally conditioned criteria for the evaluation of potential employees.

Business should continue its support of education as part of an overall responsibility for serving the public welfare, but we must use our leverage to transform education — deemphasizing it as the major credential for professionalism. This involves the support of projects which allow "subprofessionals" and "nonprofessionals" an opportunity to contribute at whatever level their experience will allow.

While we are supporting efforts to put the educational enterprise back on the right track, we also must give support to attempts to democratize our legal institutions. Much has been said about providing legal services for the poor and many programs have been devised to do so. However, the only effective programs are those with enough independence to attack not only injustice but also to call into question the practices of those legal institutions which administer justice.

The major challenge to our legal and economic institutions may turn out to be in the area of consumer protection, an area of special sensitivity to business. But, in my opinion, it is still true that the poor who can least afford to have their earnings diminished by higher prices pay more for the same merchandise which is available at much cheaper prices to the middle class.*

Finally, not only our economic, legal and educational institutions must be democratized, but also our political institutions. While corporate contributions programs are restricted by the Tax Reform Act of 1969 to the support of nonpolitical enterprises, there is still much that can be done to enable minority communities to acquire the tools to break down the doors of closed political processes.

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*David Caplovitz, *The Poor Pay More* (New York: Free Press, 1963).

Developing Power

Power will not be substantially domesticated nor democratized until nonwhite minorities develop a power base which will, in some instances, allow them to confront power with power. Where it is not possible to transform the "establishment," it may be necessary to develop an establishment on the outside. Democratizing power concerns sharing existing resources, but developing power has to do with creating new power systems.

Finally, some corporations may continue the developing trend toward pooling resources with others who are interested in embarking on cooperative ventures. A technical assistance project has just been set up in Atlanta and a few people have been meeting with representatives of business and foundations in New York to discuss how these two types of institutions might cooperate in minority community development efforts. We are seeking to integrate philanthropy with new business starts, the use of suppliers, the selection of plant sites and the total function of the corporation. While business still has a long way to go, the advantage of the Cummins approach is that we have made a start.

Conclusion

Some people still argue that business has no public responsibility. I believe that our survival in the very long run is as dependent upon responsible citizenship as it is on responsible technological, financial and production performance. Therefore, I conclude with the same warning with which I began. No corporation will long survive unless it operates in a healthy society. It is in the self-interest of business corporations to use their resources to help save the communities in which they operate if they are to save themselves.

CORPORATE GIVING MEASURES

Thomas Vasquez †

I

DEVELOPMENT OF CORPORATE GIVING, 1935-1970

In 1935 an amendment to the Internal Revenue Code allowed corporations to deduct charitable contributions in computing taxable income. While this amendment limited the deduction to 5 percent of net income,[1] the average contribution level[2] was only about 0.4 percent of net income until after World War II when the level of giving increased to about 1 percent of net income. This level of corporate giving remained relatively constant through 1970. Table 1 shows the pattern of corporate charitable contributions from 1936 to 1970. The peak years for corporate giving were 1968 and 1969, when corporations gave more than $1 billion, more than 35 times the $30 million given in 1936. Of course, corporate profits also grew dramatically during the period, but only one third as much as contributions, which is indicated by the change in the level of contributions as a percent of net income, an increase from 0.38 percent in 1936 to 1.17 percent in 1970. The most meaningful statistic of Table 1 is the ratio of contributions to net income which most closely represents the attitude of corporations to charitable giving. While clearly not a monotonic function, the ratio has been increasing during the entire period. The few obvious deviations are in 1945, 1952 and 1953, but beginning in 1958 at 1 percent of net income, the level increased fairly steadily to 1.28 percent in 1969 and then decreased slightly to 1.17 percent in 1970.

The corporate sector in the U.S. comprises a large number of firms, most of which are relatively small and contribute little to total economic activity. The few giant corporations dominate investment, production, and most other business activity. While not as pronounced in earlier years, these giant corporations also dominate charitable giving. In 1970, 0.2 percent of all firms accounted for more than half of total corporate charitable contributions.

Table 2 indicates the increasing role played by large corporations in the realm of charitable giving. Firms with assets of $100 million or more controlled 48 percent of total corporate assets in 1940; but this percent increased only slightly to almost 57 percent in 1970. The percent of all corporate charitable contributions made by these firms, however, nearly tripled during the same period, from 20.5 percent in 1940 to 54.5 percent in 1970. The major reason for this is not a large increase in the percent holding of net income by this class of corporations, but rather a more than four-fold increase in its level of giving, from 0.21 percent of net income in 1940 to 0.98 percent of net income in 1970. These giant firms are not the only size class to show an increased concern toward charitable contributions. With the exception of the class of firms with $100,000 or less in assets, all classes show an increase in the level of giving relative to their net income. The implication is that corporations, for whatever reason, are making charitable contributions a more substantial part of their business activity.

While the tabulations in Table 2 indicate substantial changes in the pattern of charitable giving by asset size, Table 3 shows that the distribution of contributions by industry group has remained relatively constant during the 30-year period, 1940-1970. The only two significant changes are in the retail trade sector, which shows a 4 percentage point reduction in percent of total contributions made, from 13.3 percent to 9.3 percent. And the finance, insurance, and real estate sector,

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† New York State Economic Development Board; former financial economist, U.S. Department of Treasury.

Table 1

Corporate Charitable Contributions, 1936-1970

Year	Contributions (in thousands)	Contributions as Percent of Net Income
1936	$ 29,968	0.39%
1937	32,727	0.42
1938	27,233	0.66
1939	30,730	0.43
1940	38,124	0.41
1941	58,000	0.35
1942	98,296	0.42
1943	159,221	0.57
1944	234,194	0.88
1945	265,679	1.24
1946	213,872	0.84
1947	241,228	0.76
1948	239,337	[illegible]
1949	222,566	0.78
1950	252,000	0.59
1951	343,039	0.79
1952	398,579	1.08
1953	494,517	1.24
1954	313,764	0.85
1955	411,082	0.96
1956	417,990	0.88
1957	415,074	0.92
1958	392,404	1.00
1959	481,575	1.01
1960	482,151	1.11
1961	511,872	1.06
1962	594,713	1.09
1963	656,602	1.11
1964	729,389	1.19
1965	785,366	1.05
1966	805,035	.99
1967	829,757	1.05
1968	1,004,803	1.15
1969	1,055,370	1.28
1970	797,029	1.17

Office of the Secretary of Treasury,
Office of Tax Analysis

August 29, 1974

which shows a 7.7 percentage point increase in the percent of total contributions made.

Some of the change in the distribution of contributions is due merely to a change in the distribution of net income as indicated by the divergent increases in the ratio of contributions to net income. While the all-industry average ratio of contributions to net income increased nearly threefold from 0.41 percent to 1.17 percent, the increase in specific industries varied considerably. Agriculture, for example, increased its ratio by more than seven times the 0.5 percent level in 1940, whereas mining, communication, wholesale trade, retail trade, and the service industry only doubled their giving ratio.

Table 2

Percent Distribution of Firms, Assets, Contributions, and Contributions as a Percent of Net Income by Asset Size Class, Selected Years, 1940-1970

Asset Size (in thousands)	Percent of Firms	Percent of Total Assets	Percent of Total Contributions	Contributions as Percent of Net Income
			1940	
Total	100.0%	100.0%	100.0%	.41%
Less than $100	60.1	2.6	6.5	1.60
100-250	14.3	2.9	5.9	.61
250-500	6.7	3.1	5.6	.63
500-1,000	4.2	3.6	7.0	.62
1,000-5,000	6.3	11.5	20.5	.52
5,000-10,000	.6	5.7	9.2	.50
10,000-50,000	.5	14.5	16.2	.37
50,000-100,000	[illegible]	8.0	7.4	.30
100,000 and over	.5	46.0	26.5	.21
			1950	
Total	100.0	100.0	100.0	.50
Less than 100	58.4	2.1	3.3	1.64
100-250	20.6	3.0	5.9	1.06
250-500	6.7	3.9	7.0	1.09
500-1,000	5.1	3.4	6.6	1.07
1,000-5,000	5.4	10.9	22.3	1.00
5,000-10,000	.9	5.8	6.6	.81
10,000-50,000	.7	14.2	17.2	.62
50,000-100,000	.1	6.9	4.6	.38
100,000 and over	.1	50.6	22.4	.20
			1960	
Total	100.0	100.0	100.0	1.11
Less than 100	61.1	1.9	2.4	2.19
100-250	19.8	3.0	3.7	1.25
250-500	9.3	3.1	4.7	1.46
500-1,000	4.6	3.2	5.5	1.62
1,000-5,000	4.2	9.6	14.7	1.57
5,000-10,000	.7	4.9	6.8	1.45
10,000-50,000	.7	13.5	15.4	1.20
50,000-100,000	.1	6.4	7.8	1.10
100,000 and over	.2	55.4	38.6	.72
			1970	
Total	100.0	100.0	100.0	1.17
Less than 100	57.7	1.2	1.9	2.53
100-250	20.2	2.0	2.6	1.07
250-500	10.2	2.3	3.9	1.38
500-1,000	5.6	2.5	4.0	1.67
1,000-5,000	4.5	5.7	11.3	1.75
5,000-10,000	.6	2.4	5.1	1.77
10,000-50,000	.6	10.9	11.2	1.45
50,000-100,000	.1	5.5	4.5	1.21
100,000 and over	.3	66.5	54.5	.96

Table 3

Contributions as a Percent of Net Income and the Percent Distribution of Contributions by Major Industry, Selected Years, 1940-1970

	1940		1950		1960		1970	
	Contributions As a Percent of Net Income	Percent Total Contributions	Contributions As a Percent of Net Income	Percent Total Contributions	Contributions As a Percent of Net Income	Percent Total Contributions	Contributions As a Percent of Net Income	Percent Total Contributions
Total	.41%	100.0%	.89%	100.0%	1.11%	100.0%	1.17%	100.0%
Agriculture	.10	.3	.32	.6	3.06	.3	3.09	.3
Mining	.29	1.5	.21	1.3	.74	1.1	.40	.9
Contract construction	.58	1.0	.99	2.3	2.03	2.3	1.62	3.1
Manufacturing	.35	46.6	.55	52.1	1.31	56.1	1.39	46.5
Transportation	.10	1.6	.21	1.7	1.23	2.1	*	1.9
Communication	.32	2.3	.36	1.1	.43	3.5	.30	5.0
Electric, gas and sanitary services	.31	5.6	.67	2.9	.86	3.3	.92	6.0
Wholesale trade	.64	7.4	.97	10.7	1.34	6.6	1.23	6.6
Retail trade	.93	13.3	1.11	13.6	1.09	7.7	1.43	9.3
Finance, insurance, real estate	.26	9.5	.41	9.6	.74	14.2	.87	17.2
Services	1.30	3.7	1.33	3.0	1.67	3.0	2.02	3.6

*Negative net income

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As seen in Table 4, corporate charitable contributions account for about 8 percent of total contributions. With the exception of a large decrease in 1970, this percentage has held fairly steadily since 1956.

Table 4

Total Personal and Corporate Charitable Contributions as Reported on Income Tax Returns, Selected Years, 1956-1970

Year	Total Contributions (in billions)	Percent of Total Contributions Made by Corporations
1956	$ 5.20	7.9%
1958	6.00	6.4
1960	7.23	6.7
1962	8.12	7.3
1964	9.06	8.0
1966	9.93	8.1
1968	12.14	8.3
1970	13.69	5.8

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II

CROSS-SECTIONAL VIEW OF CORPORATE GIVING, 1970

The information presented in the first section of this paper is valuable in that it places in perspective and traces the development of corporate charitable contributions over the last 35 years. Certainly, it is of some interest that since the mid-1950s corporations have fairly consistently made contributions averaging 1 percent of net income. As will be shown in this section, however, averages are particularly misleading in the area of corporate charitable contributions.

In 1970, 1.7 million corporations filed income tax returns but only 20 percent of these firms made charitable contributions and only 6 percent of the total number of firms made contributions of over $500. Table 5 shows the distribution of firms by size of contribution. The most striking figures are that nearly 50 percent of total corporate charitable contributions is made by less than 0.05 percent of all corporations and more than 75 percent of all contributions is made by the 0.4 percent of firms that contributed at least $10,000.

Also shown in Table 5 is that 2.2 percent of firms with negative income made charitable contributions. Given the 5 percent of net income limitation on charitable

Table 5

Percent Distribution of Firms and the Amount of Charitable Contributions by Size of Contributions, 1970

Size of Contribution	Contributions		Percent of Total Firms With		All Firms
	Amount (in thousands)	Percent	Net Income	Deficit	
0	$ 0.0	0.0%	67.9%	97.8%	80.2%
Less than $500[a]	0.0	0.0	21.9	1.9	13.7
$500-1,000	61,076	7.8	6.1	.2	3.7
$1,000-5,000	79,290	10.1	2.8	.1	1.7
$5,000-10,000	43,592	5.6	.6	*	.4
$10,000-25,000	61,037	7.8	.4	*	.2
$25,000-50,000	47,936	6.1	.1	*	.1
$50,000-100,000	52,068	6.6	.1	*	.1
$100,000-200,000	51,934	6.6	*	*	*
More than $200,000	388,816	49.5	.1	*	*
Total	$785,776	100.0%	100.0%	100.0%	100.0%

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*Less than .05%.

a. Entries on the corporate file used to generate this table are rounded to thousands of dollars. Entries of less than $500 are rounded to zero, An indicator is used to differentiate zero entries from entries rounded to zero. While a count of firms with rounded entries can be made, the amount of contributions cannot be determined.

contributions, these firms are not allowed to use the contributions as a deduction. The data base is comprised of unaudited returns, and these deductions will eventually be disallowed.[4] Excluding firms with a deficit, the percent of firms making a contribution is 32.1 percent of firms with positive income; 10.2 percent of firms with net income made contributions of more than $500.

Table 6 shows the number and percent of firms making contributions and the average contribution by the same size class of contributions used in Table 5. Table 5 indicated that the largest size class accounted for 50 percent of total contributions. As indicated in Table 6, there are only 516 firms in this class; they gave an average of more than $750,000 which was 1.16 percent of their net income.

While Tables 5 and 6 clearly indicate that only a few firms dominate charitable giving, this result is consistent with the general nature of U.S. business. The U.S. economy is characterized by a large number of small firms and a few very large

Table 6

Number and Percent Distribution of Firms Making Contributions, Average Contribution, and Contributions as a Percent of Net Income by Size of Contribution, 1970

Size of Contribution	Firms Making Contributions		Contributions As a Percent of Net Income[a]	Average Contribution[a] (in thousands)
	Number	Percent		
Less than $500[b]	228,493	69.1%	0.0%	$ 0.0
$500-1,000[b]	61,076	18.5	1.45	1.0
$1,000-5,000	28,350	8.9	1.45	2.8
$5,000-10,000	5,811	1.8	1.49	7.5
$10,000-25,000	3,818	1.2	1.44	16.0
$25,000-50,000	1,339	.4	1.33	35.9
$50,000-100,000	751	.2	1.21	69.3
$100,000-200,000	377	.1	1.17	137.6
More than $200,000	516	.2	1.16	755.3
Total	330,532	100.0%	1.15%	$ 2.5

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a. Excludes firms with a deficit.
b. Entries on the corporate file are in thousands of dollars, thus amounts less than $500 are rounded to zero and amounts between $500 and $1,000 are rounded to $1,000.

firms which dominate production, employment, investment, and most other business activity. The absolute levels of charitable contributions show a large variance (from zero to more than $1 million for a few firms), but clearly a second, and perhaps a more meaningful, way to compare charitable contributions is to look at contributions as a percent of net income. Table 7 provides such a tabulation, and the results are somewhat striking. Twenty-seven percent of charitable contributions are made by firms giving at least 5 percent of net income, and while only 3 percent of all firms with positive net income give at this level, this 3 percent represents 29 percent of firms making contributions. Another interesting result of Table 7 is that firms making contributions at a level of 1 percent or less of net income tend to have higher average absolute levels of contributions. The highest average contribution level of $17,700 is made by firms giving between 0.6 and 0.8 percent of net income.

Table 8 disaggregates the results of Table 7 to 11 industry sectors. The "total" row of Table 8 is calculated directly from Table 7 and shows that 60.4 percent of firms making contributions of more than $500 made contributions of at least 3

Table 7

Percent of Firms, Percent of Total Contributions, Percent of Net Income, and the Average Contribution Per Firm for Firms With Positive Income, by Contributions as a Percent of Net Income Size Classes, 1970

Contributions as a Percent of Net Income	Percent of Firms	Percent of Contri-butions	Percent of Net Income	Average Contribution (in thousands)
0%	89.8%	0%	25.4%	$ 0
0-0.2	.2	.9	9.7	5.0
0.2-0.4	.3	4.8	13.8	12.3
0.4-0.6	.4	4.5	8.9	10.2
0.6-0.8	.3	7.7	10.4	17.7
0.8-1.0	.4	6.6	7.0	15.0
1.0-1.2	.3	3.8	3.2	9.1
1.2-1.4	.3	4.2	3.0	10.7
1.4-1.6	.3	3.5	2.2	9.8
1.6-1.8	.3	4.8	2.6	13.9
1.8-2.0	.3	2.1	1.0	5.6
2.0-2.5	.6	4.3	1.8	5.8
2.5-3.0	.5	5.8	2.0	8.8
3.0-4.0	1.4	8.7	2.4	5.0
4.0-5.0	1.7	11.7	2.4	5.5
5.0 and over	3.0	26.6	4.4	7.1
Total	100.0%	100.0%	100.0%	$ .8

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percent of net income and that these firms accounted for 47 percent of total contributions. With the exception of the utility industries—communication and the electric, gas, and sanitary service industry—each industry sector follows a similar pattern. More than half of the firms making contributions of more than $500 give at least 3 percent of net income. The utility industries deviate from this pattern due to a number of reasons. One reason is that these industries are regulated, and a critical legal question arises over the right of a regulated company to request higher service rates due to the cost incurred in making a charitable contribution. Low percentage levels of giving may be acceptable to regulatory agencies. A second reason rests on the behavior of large firms in general. Independent of the industry or level of government intervention, large firms, while giving large absolute amounts,

Table 8

Percent of Firms and Percent of Contributions Made by Firms, by Selected Levels of Contributions as a Percent of Net Income, by Industry (Corporations Only), 1970

Industry	Contributions As A Percent of Net Income: At Least 3 Percent — Number of Firms as % of: All Firms With Net Income	At Least 3 Percent — Number of Firms as % of: Firms Making A Contribution of $500 or More	At Least 3 Percent — Percent of Total Contributions	At Least 4 Percent — Number of Firms as % of: All Firms With Net Income	At Least 4 Percent — Number of Firms as % of: Firms Making A Contribution of $500 or More	At Least 4 Percent — Percent of Total Contributions	5 Percent or More — Number of Firms As % of: All Firms With Net Income	5 Percent or More — Number of Firms As % of: Firms Making A Contribution of $500 or More	5 Percent or More — Percent of Total Contributions
Agriculture	2.7%	61.6%	59.3%	2.1%	46.4%	38.0%	1.4%	31.3%	27.0%
Mining	5.3	48.5	33.6	3.9	35.4	29.3	2.2	20.3	15.2
Contract construction	6.8	64.1	61.0	5.0	47.1	47.9	3.1	29.3	31.2
Manufacturing	10.1	48.6	41.1	7.6	37.7	33.7	4.9	23.8	24.2
Transportation	3.2	58.3	67.5	2.4	46.2	56.2	1.7	34.1	48.5
Communication	4.6	47.0	27.4	3.6	38.5	27.0	2.5	25.7	7.5
Electric, gas and sanitary services	2.8	28.4	23.9	1.8	16.8	20.3	1.6	16.4	15.5
Wholesale trade	8.0	59.1	62.8	5.9	43.3	50.1	3.6	26.7	32.2
Retail trade	5.7	71.0	47.3	4.4	55.6	35.6	2.8	35.4	23.5
Finance, insurance and real estate	4.6	59.6	60.5	3.6	46.5	50.4	2.4	31.2	35.9
Services	4.0	69.4	61.2	3.2	54.9	45.9	2.1	37.0	32.5
Total	6.1%	60.4%	47.0%	4.7%	46.5%	38.3%	3.0%	29.4%	26.6%

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tend to limit their contributions to a lower than average percent of net income, and clearly the utility industries are, for all practical purposes, dominated by a handful of giant companies.[4]

Tables 5 through 8 are concerned primarily with the size of contributions both in absolute terms and in relation to the net income of the firm. Tables 9, 10, and 11, however, are concerned more with describing the firms making contributions. Table 9 provides a description of charitable contributions by industry group. While only 36.5 percent of all firms with net income made charitable contributions in 1970, these firms controlled 83.4 percent of total assets, which supports the contention that contributing firms are larger than average. This fact holds in every industry group of Table 9 with the effect most pronounced in the two utility industries where more than 95 percent of the assets are controlled by firms making contributions. The two utility industries are also differentiated by their relatively large average contribution which is more than 8 times the average contribution for all firms, $790.

The manufacturing sector stands out most notably in the area of charitable contributions with 48.1 percent of firms with positive income making a contribution. These firms control 95.1 percent of the assets in the manufacturing sector, which is the highest participation rate of all sectors excluding the utility industries. In addition, this sector accounts for 50 percent of all contributions while accounting for only 19 percent of total assets and 12 percent of total firms.

Tables 10 and 11 look at much the same items as in Table 9, but are tabulated by asset size rather than by industry group. The first four columns of Table 10 show the percent distribution of selected items by asset size class. As indicated above, the large firms dominate most business activity. Eighty-five percent of all firms own only 3.9 percent of total assets and produce only 12.8 percent of net income. The role of these firms in the charitable contribution area is also minimal. They account for only 7.1 percent of total contributions with gifts averaging less than $100 at a level of only about 0.4 percent of net income.

Of course, as asset size increases, the absolute level of average contributions increases, to a high of nearly $650,000 for firms with $1 billion or more of assets. More interesting, however, is the pattern shown when contributions are expressed as a percent of net income. Relatively large firms with assets of between $5 million and $500 million give at a level of about 1.2 percent of net income, higher than the level given by smaller firms. The percent drops to 0.8 percent for giant companies of $500 million or more of assets which is slightly lower than 0,9 percent average for all firms.

Table 11 shows the participation of firms with net income in the charitable contribution area by asset size class. As asset size increases, the percent of firms making a contribution increases. While there are only slight variations in the higher asset size groups for firms with net income, for all firms the participation rate drops to 75.4 percent in the $1 billion and over asset size class from a high of 86.7 percent in the $500 million to $1 billion size class. Eighty-five of the 346 firms in this class do not report charitable contributions. The percent of assets owned by firms reporting contributions follows much the same pattern as the percent of firms, with the exception of the largest size class. Apparently, those making contributions in that class are smaller than the class average. Of course, contributions as a percent of net income are higher when noncontributing firms are excluded, and the pattern changes considerably across asset size classes. While the pattern is not monotonic, the general trend is an increase to 1.6 percent of net income in the $500,000 to $1 million size class and a gradual decrease to 0.9 percent in the two largest asset classes.

Table 9

Percent Distribution of Firms, Charitable Contributions, and Average Contributions for Firms With Net Income, by Major Industry Group, 1970

Industry	Firms		Assets		Percent of Charitable Contributions	Average Contribution (in dollars)
	Percent of Total	Firms Making Contributions as a Percent of Total Firms in the Industry	Percent of Total	Assets of Firms Making a Contribution as a Percent of Assets of All Firms in the Industry		
Agriculture	2.0%	20.0%	.3%	88.2%	.3%	$ 110
Mining	.7	32.5	.7	78.7	.9	1,000
Contract construction	8.1	34.4	1.2	66.6	3.0	290
Manufacturing	12.0	48.1	19.1	95.1	50.2	3,320
Transportation	2.9	25.4	1.7	75.4	1.8	490
Communication	.5	34.3	2.8	97.7	5.1	5,280
Electric, gas, and sanitary services	.4	26.9	4.2	95.7	4.1	7,770
Wholesale trade	11.8	41.2	2.7	76.0	6.7	450
Retail trade	21.9	35.7	3.3	75.3	9.1	330
Finance, insurance, and real estate	24.9	20.8	47.0	76.5	17.3	550
Services	14.6	27.5	17.2	62.6	3.6	190
Total	100.0%	30.9%	100.0%	83.4%	100.0%	$ 790

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Table 10

Percent Distribution of Firms, Assets, Charitable Contributions, and Net Income and the Average Contribution Per Firm and Contributions as a Percent of Net Income for Firms Having Positive Income, by Asset Size Class, 1970

Asset Size (in thousands)	Percent Distribution				Average Contribution (in thousands)	Contribution as a Percent of Net Income
	Firms	Assets	Contribution	Net Income		
$0	2.1%	0.0%	.5%	.8%	$ .2	.6%
$0-25	16.4	.1	.1	.6	.0	.1
$25-50	12.5	.2	.2	.8	**	.2
$50-100	17.6	.5	.5	1.8	**	.3
$100-500	36.3	3.1	5.8	8.8	.1	.6
$500-1,000	7.0	1.8	4.7	4.4	.5	1.0
$1,000-5,000	5.6	4.2	11.5	9.5	1.6	1.1
$5,000-10,000	1.0	2.6	5.2	3.9	4.2	1.2
$10,000-25,000	.6	4.8	6.2	4.8	5.9	1.2
$25,000-50,000	.3	4.2	5.2	4.1	12.6	1.2
$50,000-100,000	.2	4.5	4.6	4.4	20.9	1.0
$100,000-500,000	.2	13.2	18.3	14.2	65.9	1.2
$500,000-1,000,000	*	7.7	8.6	9.9	229.9	.8
$1,000,000 and over	*	53.1	28.6	31.9	643.7	.8
Total	100.0%	100.0%	100.0%	100.0%	$ .8	.9%

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* Less than .05%
**Less than $50

Table 11

Firms, Assets, and Net Income for Firms Making Contributions as a Percent of All Firms, by Asset Size Class for Firms With Positive Income (Corporations Only), 1970

Asset Size (in thousands)	Firms		Assets		Net Income		Average Contribution (in thousands)	Contribution as a Percent of Net Income
	Percent of Total Firms	Firms Making a Contribution as a Percent of Total Firms in the Asset Size Class	Percent of Total	Assets of Firms Making a Contribution as a Percent of Total Assets in the Asset Size Class	Percent of Total	Net Income of Firms Making a Contribution as a Percent of Total Net Income in the Asset Size Class		
$0	1.0%	15.3%	0.0%	0.0%	.5%	33.9%	$ 1.2	1.0%
$0-25	6.2	16.0	*	18.4	.1	14.6	**	.9
$25-50	7.4	23.8	.1	24.1	.2	20.0	.1	1.2
$50-100	13.0	29.7	.2	30.0	.6	26.3	.1	1.0
$100-500	42.4	43.5	1.8	46.0	4.7	42.9	.3	1.4
$500-1,000	11.9	56.1	1.4	56.6	3.4	62.4	1.0	1.6
$1,000-5,000	11.5	67.9	4.1	66.6	9.0	76.6	2.5	1.5
$5,000-10,000	2.4	79.0	2.9	79.1	4.1	84.4	5.3	1.5
$10,000-25,000	2.2	83.5	5.7	83.6	5.1	85.4	7.1	1.4
$25,000-50,000	.9	85.4	5.2	85.1	4.5	87.6	14.7	1.3
$50,000-100,000	.5	83.3	5.3	83.0	4.6	84.6	25.1	1.1
$100,000-500,000	.4	84.4	15.9	84.7	15.6	88.8	101.8	1.4
$500,000-1,000,000	.1	86.7	9.7	87.4	11.5	94.5	265.2	.9
$1,000,000 and over	.1	75.4	47.7	62.9	36.1	91.6	654.3	.9
Total	100.0%	36.5%	100.0%	70.0%	100.0%	86.9%	$ 3.5	1.2%

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* Less than .05%
** Less than $50

Footnotes

1. The 5% limit is computed without regard to the charitable deduction.

2. A corporation may contribute the use of its employees rather than making a gift of cash or property. If the former type of gift is made, the deduction is reported as a business expense rather than as a charitable contribution. Contributions reported as business expenses cannot be tabulated and thus are not included in total contributions. This qualification holds for all such references in the paper.

3. The statutory limitation is 5% of taxable income plus the charitable contribution and excluding certain items such as the deduction for domestic dividends received, interest on U.S. obligations, Western Hemisphere Trade deductions and a few other less important items. These exclusions, in effect, limit the deduction to 5 percent of net income plus the amount of the contribution.

4. Charitable contributions above the 5% limit may be carried over to the 5 succeeding taxable years, and these years are also subject to the 5% limit. This fact points out one further shortcoming of the data. The contributions in the corporate file refer to the amount taken as a deduction in 1970. To the extent of carry forwards, the deductions reflect contributions made in prior years.

5. Forty-one companies, which is only 0.5% of the number of firms in the two industry sectors, have assets of more than $1 billion and control more than 70% of the assets of the two industries.

CORPORATE CHARITABLE CONTRIBUTIONS

R. Palmer Baker, Jr.[†] and J. Edward Shillingburg[†]

Introduction

Business corporations, which control the most dynamic aspects of the nation's economy and much of its wealth, provide less than 5 percent of all philanthropic contributions. Estimates of total charitable contributions, by source, for 1972 and 1974 are as follows:[1]

Source	1972 (in billions)		1974 (in billions)	
Individuals	$16.91	74.6%	$19.80	78.5%
Bequests	2.73	12.0	2.07	8.2
Foundations	2.20	9.7	2.11	8.4
Corporations	.84	3.7	1.25	4.9

But the amount provided by corporations is an extremely important portion. In absolute amount it is greater than the 1971 federal income taxes raised from individuals in each of 32 states and is slightly less than the 1973 federal expenditures for agriculture and rural development.[2] The average size of gifts made by corporate donors is usually substantially greater than those of individuals. Finally, individual giving in large part goes to religious organizations, while corporate contributions are concentrated in the health, welfare, and higher education fields.

Although corporate giving is an important element in philanthropy, it averages only about 1 percent of pre-tax corporate income—substantially below the 5 percent level permitted by the federal government for charitable deduction purposes.[3] At a 5 percent level of contribution, corporate giving for 1974 would be approximately $5.8 billion. This $4.63-billion increase would cost corporations only $2.22 billion, with the remainder, through the tax deduction, being made up of funds otherwise paid as taxes.

As a number of commentators have recently stressed, the charitable deduction represents an indirect allocation of government funds for private action and thus embodies some policy decisions on the appropriate role of private action.[4] The corporate contribution, in addition, involves assumptions of customer and stockholder relationships. These assumptions are seen most clearly in the case of regulated utilities, where the allowance of the contribution for rate-making purposes is an unresolved issue.

Notwithstanding these policies and tensions, it is generally accepted that the business corporation has a substantial responsibility to the community in which it does business and that this responsibility is only partially met through the existing level of charitable contributions. The purpose of this paper is to review the legal and tax considerations related to corporate giving, the sources and the disposition of the bulk of corporate contributions, and to consider a rationale for corporate giving.

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I

CORPORATION LAW AND TAX FRAMEWORK[5]

Historical Background

The legal authority for corporate giving has developed from very restricted beginnings. In the 1800s the courts, applying the general principle that a corporation possessed only limited powers, concluded that corporate support of charitable causes was an ultra vires action since it was not expressly included among the purposes for which the corporation had been organized. This problem faded as states began toward the end of the 1800s to liberalize their corporation statutes to authorize actions that were incident to the principal corporate purposes.

The next developmental phase involved the judicial requirement that charitable contributions benefit the corporation. Contributions were sustained where they reflected business considerations and where they resulted in a reasonably direct benefit to the corporation. These cases largely involved what might be referred to as "commercial" contributions. Examples were contributions by railroads to attract industry to the areas they served. Contributions involving individual need were primarily directed to employee programs, such as programs for tubercular employees, death benefits, and business schools which were a source of manpower for the donor corporation. Perhaps the first case to break with this pattern of giving was the approval in 1924 of a railroad practice of giving free passes to ministers.

One of the reasons for the vitality of the corporate benefit test was the federal tax law. The Regulations under the 1921 and subsequent Revenue Acts permitted a corporation only a limited deduction—as a business expense—for those "donations" made

> for purposes connected with the operation of its business, . . . when limited to charitable institutions, hospitals or educational institutions conducted for the benefit of its employees or their dependents . . . [or] which legitimately represent a consideration for a benefit flowing directly to the corporation as an incident of its business.[6]

The courts rigorously applied the benefit test of the Regulations, and thus upset many contribution deductions. Congress, however, in 1935 extended to corporations the charitable income tax deduction which had been available to individuals since 1917.

Developments were significantly accelerated by Professor Merrick Dodd's assertion in 1932 of the responsibility of corporate directors to conduct business in the interests of employees, consumers, and the general public—as well as stockholders. He argued that

> . . . public opinion, which ultimately makes law, has made and is today making substantial strides in the direction of the view of the business corporation as an economic institution which has a social service as well as a profit-making function, that this view has already had some effect on legal theory, and that it is likely to have a greater increased effect upon the latter in the near future.[7]

Present Corporate Law Situation

Business Corporations

The corporate law governing charitable giving is dominated by a New Jersey Supreme Court decision and by legislative developments in almost all of the states.

In the *A.P. Smith Manufacturing Co.* case a New Jersey corporation with 300 employees had contributed $1,500 to Princeton University prior to the enactment of a New Jersey State law permitting corporate charitable gifts.[8] The Supreme Court of New Jersey sustained the validity of the gift on three alternative bases:

1. That the donation reasonably promoted corporate objectives and benefitted the corporation—even if only "viewed strictly in terms of actual survival of the corporation in a free enterprise system" by virtue of a claimed interaction of private institutions of higher education and the free enterprise system;

2. That the statutory confirmation of the corporate power to make charitable contributions was retroactive; and

3. That corporate charitable contributions were valid—aside from the presence of a direct benefit or express statutory authorization—because of the responsibility of business to the community.

This last basis for the decision is considered the most important since it recognizes that business corporations have an affirmative duty to support the community through contributions. However, even under the broadest reading of *Smith,* it is clear that there must be some reasonable nexus between the corporation's business and the contribution. Thus, a contribution to a charity exclusively for the benefit of an officer or dominant shareholder would be open to question.[9]

On the legislative side, all of the states (except Arizona and Idaho) beginning with Texas in 1917 have adopted amendments to their corporation law which expressly authorize corporate contributions. These measures vary widely in their detail, but typical of their basic principle is §4(m) of the Model Business Corporation Act, which provides that every corporation shall have power "to make donations for the public welfare or for charitable, scientific or educational purposes."[10]

Regulated Industries

The legal developments for charitable contributions by business corporations primarily reflected changes in attitudes toward the nature and powers of corporations. The question of who bears the economic burden of such contributions—the consumer or the stockholder—was not directly raised.[11] However, that issue has been sharply presented for utilities and other regulated industries in relation to the rate-making process. Blumberg found that only a slim majority of the 19 jurisdictions considering this issue at a judicial level had permitted a charge against the rate payers. Of the 26 jurisdictions that had considered the issue on an administrative level, only 6 had permitted their allowance.[12] A study published by the Council for Financial Aid to Education in 1972 found the following results:[13]

Policies Regarding the Allowance of Contributions as an Operating Expense for Rate-Making Purposes

	Judicial Ruling	Agency Ruling	Staff Letter[a]
Favorable	11[b]	8[b]	15
Unfavorable	9	19[c]	18
No policy			4

a. Responses of state public utility commissions to a 1971 AEC survey.
b. Does not include one federal rate ruling.
c. Does not include three federal agency rulings.

Those authorities who disallow contributions as a rate charge generally find an absence of corporate benefit, as well as a concern that they reflect a levy on the rate payers. Those favoring the allowance speak in terms of benefit and community responsibility and frequently refer to the reasonableness or modest nature of the contributions themselves. The council study analyzes these arguments in detail and provides a convincing brief for allowance of contributions for rate-making purposes.[14]

An interesting recent development in this field is a proceeding filed in the Ohio Public Utilities Commisssion by the Ohio Citizens' Council for Health and Welfare. This action was sparked by a decision of the Ohio Utilities Commission to move away from allowance of charitable contributions for rate-making purposes. The complaint (attached here as Appendix A) is interesting for the detailed reasons for reversal and for the regulations proposed to deal with such expenditures.

Present Tax Law

The federal charitable income tax deduction for corporations is limited to 5 percent of taxable income computed without regard to the charitable, net operating loss, and certain other special deductions.[15] Contributions in excess of the limitation may be carried forward and treated as contributions made in the five following years. Unlike the charitable deduction for individuals, no distinction is made for percentage limitation and carry-forward purposes between contributions to public charities and to private foundations.[16]

For individuals, the standards for what constitutes a charitable contribution are that the gift must be made to domestic governmental units for "public purposes," to domestic trusts, corporations and associations organized exclusively for "religious, charitable, scientific, literary, or educational purposes," to certain veterans organizations, and to certain fraternal societies. These standards also apply to corporations, with two exceptions: (1) corporate contributions to trusts and other noncorporate donees must be used within the United States, and (2) no corporate deduction is allowed for contributions in support of the charitable programs of a fraternal society.[17]

The rules applicable to individuals in computing the amount of a charitable contribution of property for deduction purposes also apply to corporations. Thus, fair market value is the starting point. Gifts of inventory and other property which if sold would produce ordinary income or short-term capital gain are deductible only to the extent of the contributor's cost or other tax basis.[18] As a result, a corporation generally will claim no charitable deduction for the gift of an inventory item but will take the usual business-expense deduction for cost of goods sold. This treatment of inventory items, adopted by the Tax Reform Act of 1969, has reduced a type of support that was of great assistance to many charitable organizations. Gifts of appreciated tangible personal property which if sold would produce long-term capital gain are taken into account at fair market value, reduced by 62.5 percent of any appreciation, if they are given to a private foundation or are given to a public charity but put to a use not related to its exempt purposes.[19]

One current issue affecting corporate donors appears to be contrary to the limitation that most contributions be used in the United States and to the principle of business responsibility to the community. It involves the proposed rules for allocating deductions between United States and foreign source income.[20] These rules treat charitable contributions as not directly related to the corporation's income. The result is to require a corporation to allocate a contribution to a local community fund between its United States and foreign source income on a pro rata basis. This has substantial consequence for foreign tax credit and other technical purposes. The comment of one group of tax professionals urging the allocation of contributions having a specific connection with a particular country to income from that country is set out in Appendix B.

In sum, at present there remain no general corporate or tax barriers to the principle of corporate contributions. However, there remain difficulties over technical aspects of the deductions, as well as the general–and substantial–issue of what in fact is "charitable."

II

THE SOURCES AND RECIPIENTS OF CORPORATE CONTRIBUTIONS

Rate of Giving

The American Association of Fund-Raising Counsel, Inc., estimates 1974 corporate contributions at $1,250 million, about 0.8 percent of estimated corporate pre-tax income and about 4.9 percent of estimated total contributions made from all sources during 1974.[21]

Data for the period 1965-1974 puts corporate contributions at slightly above 1 percent of taxable income:

Table 1

Philanthropic Contributions of Corporations 1965-1974

Year	Profits Before Tax (in billions)	Amount Contributed (in millions)	Contributions as percent of pre-tax income
1965	$ 77.8	$ 785	1.01%
1966	84.2	805	.96
1967	79.8	830	1.04
1968	87.6	1,005	1.15
1969	84.9	1,055	1.24
1970	74.0	797	1.08
1971	83.6	865	1.03
1972	99.2	1,009	1.02
1973	122.7	1,140	.93
1974	140.7	1,250	.89

Source: American Association of Fund-Raising Counsel, Inc., *Giving USA* (1975), pp. 16-18, revised October 1975.

The rate of corporate giving, compared with taxable income, has shown a steady growth from 0.4 percent for 1936–with peaks during the excess profits tax years of 1945 and 1953 of 1.25 percent and 1.24 percent, respectively – to .84 percent for 1974.

The Conference Board has conducted surveys of many corporations, both large and small, for a number of years.[22] The Conference Board's most recent biennial survey of company contributions was conducted in 1972. It covered 443 companies who contributed a total of $323 million, estimated by the survey to be a little more than one third of all corporate giving.[23] (See Appendix C.) The survey figures would not necessarily match tax return figures since it aggregates direct company giving with distributions made by company foundations and does not include company contributions to company foundations. However, the survey includes estimates for gifts of materials and equipment.

The Conference Board's 1972 study of 358 noninsurance companies[24] reflected groupings of companies by rate of giving, as shown in Table 2.

Table 2

1972 Ratio of Contributions to Pre-Tax Net Income, Grouped by Rate of Giving (Insurance companies excluded)

% Contributions to Net Income Before Taxes	Number of Companies
-1%	190
1-1.99	107
2-2.99	30
3-3.99	12
4-4.99	3
5-5.99	2
6-6.99	1
7-7.99	...
8-8.99	2
Over 9%	5
Total	352[a]

a. Income deficits were reported by 6 of the 358 companies.

Source: Conference Board, "Biennial Survey of Company Contributions," Report No. 606 (1973), Table 4.

Other groupings of the companies in the Conference Board survey – by size of assets and by number of employees – indicate that companies with smaller employee groups and with smaller assets gave a substantially higher percentage of their income to charity than did the larger companies.[25] All of these tabulations indicate that the 5 percent charitable deduction limitation is not a substantial limitation on giving for many corporations. However, several corporations did contribute in excess of that amount.

Recipients

The Conference Board Survey also contains a detailed analysis of where corporate contributions went. The companies surveyed primarily channeled their 1972 contributions into health and welfare (42 percent) and higher education (33.6 percent), while civic improvements received a smaller proportion (9.14 percent). Only nominal amounts went to religious causes (0.4 percent); museums, performing arts, and other cultural groups received a somewhat higher proportion (4.1 percent). Table 3 gives a detailed breakdown of the purposes for which amounts were contributed.

The Conference Board's surveys during the period 1959-1972 reflect a number of trends: (1) Health and welfare and higher education are the principal recipients of corporate giving, although in recent years they have declined a few percentage points; (2) amounts given to cultural and civic groups have increased substantially; and (3) capital grants, about 14 percent of total giving in 1972, have dropped substantially (especially those to hospitals) from the approximately 20 percent level found in 1965 and 1968. Table 4 summarizes the results of the Conference Board's surveys made during the period 1959-1972.

The survey also indicates that support by large corporations of public broadcasting is a recent and substantial development.[26]

A 1973 survey conducted by the insurance industry and limited to insurance companies reflects a similar distribution of grants.[27] The 135 companies, representing more than 80 percent of the assets of all companies belonging to 3 major insurance trade groups, reported money contributions in the United States of about $17.5 million for 1972, as shown in Table 5.

III

COMPANY FOUNDATIONS

Use of Company Foundations

A number of business corporations employ affiliated nonprofit organizations – commonly called company foundations – to administer part of their charitable giving. (For purposes of this report, company foundations do not include those charitable organizations that were established primarily to carry out the charitable purposes of the principal shareholders of the company.) The Foundation Center estimates that there are about 1,500 such foundations. The Conference Board found in 1972 that 223 (about half of the 443 companies surveyed) had company foundations and that grants from companies with foundations made up about 58 percent of the total $323 million of charitable gifts made by the companies surveyed.[28]

Use of a company foundation does not appear to lead to a different pattern of distribution of funds. The Conference Board's 1972 survey (see Table 3) indicates that there is little variation in the fields supported by companies with foundations and by those without. However, a company foundation does enable the business corporation to utilize additional techniques. Direct corporate giving, largely determined by the company's profits for the year, reflects the fluctuation in the company's year-to-year performance. By using a foundation, the company can contribute in profit years and build up a small corpus which is available to supplement smaller contributions in lean years. This permits more consistent and continuing support to charitable recipients and permits more long-term planning in grant making. A company foundation also permits better management by centralizing responsibility for the program. And by concentrating many of the charitable programs in one place, personnel will develop expertise in program development and administration. Finally, foundation grants produce publicity for all divisions and affiliated organizations.

Typically, a business corporation having a number of plants and offices around the country will divide its philanthropic budget between local giving and the company foundation. The local plants and other operating units will contribute directly to local community funds and health and welfare agencies, while company foundations will concentrate on higher education, including capital and research grants and scholarship.

Effect of Recent Legislation

The Tax Reform Act of 1969 adopted a number of restrictions on the operation of foundations that derive their support from a few contributors (so-called "private foundations"). A 1973 Conference Board study found that these restrictions have led to the reduction of the funds distributed through company foundations for a number of reasons, including the new rules relating to gifts of appreciated property

Table 3

The Company Contributions Dollar, 1972

	443 Companies		220 Companies without Foundation		223 Companies with Foundation	
	Thousands of Dollars	% of Total	Thousands of Dollars	% of Total	Thousands of Dollars	% of Total
Health and welfare						
Federated drives: United Funds and the like	$85,951	26.65%	$38,372	28.50%	$47,579	25.32%
National health agencies (not included above)	3,304	1.02	1,275	.95	2,028	1.08
National welfare agencies (not included above)	5,935	1.84	2,390	1.77	3,545	1.89
Hospitals						
Capital grants	15,974	4.95	6,231	4.63	9,742	5.18
Operating grants	1,919	.59	699	.52	1,219	.65
Other local health and welfare agencies	14,392	4.46	4,652	3.46	9,739	5.18
Capital grants (excluding hospitals)	8,037	2.49	4,041	3.00	3,996	2.13
Total health and welfare	135,514	42.01	57,662	42.82	77,852	41.43
Education						
Higher education						
Scholarships	13,837	4.29	4,993	3.71	8,844	4.71
Fellowships	4,559	1.41	2,135	1.59	2,424	1.29
Research grants (not treated as a business expense)	8,102	2.51	2,998	2.23	5,103	2.72
Capital funds	17,740	5.50	7,264	5.39	10,476	5.58
Direct unrestricted grants	37,299	11.56	18,867	14.01	18,431	9.81
Grants to state, area and national fund-raising groups	8,497	2.63	3,356	2.49	5,141	2.74
Education-related agencies	3,151	.98	999	.74	2,151	1.15
Other	15,341	4.76	4,657	3.46	10,684	5.69
Secondary education						
Capital grants	645	.20	164	.12	480	.26
Other	7,700	2.39	3,659	2.72	4,040	2.15
Total education	116,876	36.23	49,096	36.46	67,780	36.07

(Cont.)

Table 3 Cont.

The Company Contributions Dollar, 1972

	443 Companies		220 Companies without Foundation		223 Companies with Foundation	
	Thousands of Dollars	% of Total	Thousands of Dollars	% of Total	Thousands of Dollars	% of Total
Culture (cultural centers, performing arts, museums, etc.)						
Operating funds	10,462	3.24	4,407	3.27	6,055	3.22
Capital grants	2,729	.85	870	.65	1,859	.99
Total cultural	13,192	4.09	5,277	3.92	7,915	4.21
Civic causes (municipal and community improvement, good government, and the like)						
Total civic	29,487	9.14	11,962	8.88	17,524	9.33
Other						
Religious causes	1,293	.40	642	.48	651	.35
Groups devoted solely to economic education	2,318	.72	696	.52	1,621	.86
Groups in U.S. whose principal objective is aid to other countries	3,418	1.06	633	.47	2,784	1.48
Causes other than above	16,604	5,15	7,984	5.93	8,620	4.59
Total "other"	23,634	7.33	9,956	7.39	13,678	7.28
Dollars not identifiable because donee unknown	3,859	1.20	699	.52	3,159	1.68
Grand Total	322,564	100.00	134,654	100.00	187,910	100.00

Source: Conference Board, "Biennial Survey of Company Contributions," Report No. 606 (1973), Table 1.

Table 4

Percentage of Gifts Made for Various Purposes, by Major Category

	1972	1970	1968	1965	1962	1959
Number of companies reporting	443	401	401	540	465	280
Total gifts	$322,564	$308,165	$263,387	$209,296	$154,142	$101,400
Health and welfare	42.01%	38.57%	37.15%	41.5%	40.9%	45.1%
Education	36.23	37.64	38.81	38.4	41.9	39.1
Culture	4.09	5.32	4.95	2.8	5.3	2.9
Civic	9.14	8.14	7.19	5.8	–	–
Other	7.33	8.10	10.39	9.2	10.3	9.5
Not identifiable	1.20	2.22	1.51	2.3	1.5	3.5

Source: The Conference Board, "Biennial Survey of Company Contributions," Report No. 606 (1973), pp. 10-11.

Table 5

1972 Company Contributions
(Number of companies reporting, 135)

	Contributions (in millions)	Percent
Urban and environmental affairs	$2.17	12.4%
Social services and community affairs	8.45	48.2
Medical education and research	1.71	9.8
General education	3.70	21.1
Research and education in business	.82	4.7
Other	.68	3.8
Total	$17.53	100%

Source: Clearinghouse on Corporate Social Responsibility, "Results of the 1973 Reporting Program of Life and Health Insurance Companies on Corporate Social Responsibility Activities' (December 1973), p. 11.

and the damaging effect on foundation innovation created by the various excise tax provisions.[29] Indeed, the Conference Board found in its survey of 223 companies with company foundations that 35 had made no contributions to the foundations during 1972.[30]

To a considerable extent, many company foundations would seem to have more in common with the so-called public charities than they do with the traditional family foundation. Certainly the operations of a foundation affiliated with a publicly held company are closely confined by the pressures of the shareholders for dividend distributions and of the company for favorable publicity. And the managers of the foundation are closely tied to the management of the company itself. Family foundations have no similar pressures and restraints. Thus, it would seem possible to draft legislation that would exclude from private foundation treatment those foundations controlled by the management of companies whose stock is widely distributed among the general public.

As a general matter, it seems probable that several of the private foundation provisions should, in themselves, have little long-term effect on company foundations. The self-dealing provisions (Code §4941) are not objectionable. While they no longer permit company foundations to invest or loan funds under any circumstance to their affiliated companies, that practice was never essential to the existence of a company foundation and probably did not have widespread use.[31]

The minimum-distribution rules (Code §4942) should not be burdensome since one of the reasons for utilizing a company foundation is to provide continuity to charitable giving. These rules may, however, pose some problems to those company foundations that have low income investments since their income may be insufficient and they will have to use principle to satisfy the contribution requirement. Similarly, the excess-business-holdings and jeopardizing-investment rules (Code §§4943, 4944) should not in themselves inhibit the use of a company foundation. Indeed, through the exception for so-called "program related investments," these rules provide a clear basis for a program that formerly was in a gray area between income-producing investments and charitable grants. Loans and equity investments may now be made in ghetto businesses where the primary purpose is to assist (that is, "charitable") and there is no significant purpose to seek a return.[32] Similarly, the lobbying and election activities rule (Code §4945(d)(1)-(2)) do not pose real problems for company foundations. The affiliated business entity may deduct as a business expense the costs of its direct expenditures for lobbying on matters of direct interest to it. However, it may not deduct expenses of "grass roots" lobbying for legislation or any expenditures relating to political campaigns.[33]

On the other hand, the expenditure-responsibility rules on grants to organizations other than public charities and the detailed steps required for grants to individuals,[34] combined with the potential foundation-manager tax,[35] have a substantial dampening effect on company foundation grant programs. Company foundation managers, although experienced business managers, may find these rules so bothersome as to lead them to prefer outright grants to established charitable organizations.

In addition, the costs of operating a charitable program through a company foundation have increased substantially. First, the 4 percent tax on net investment income reduces the funds otherwise available for the foundation's program, although the tax rate is less than that applicable to the business corporation itself on dividends (7.2 percent) and interest (up to 48 percent).[36] Additional administrative costs are now necessary to satisfy the expenditure-responsibility rules on grants to nonpublic charities and the procedures for grants to individuals. Additional legal costs are incurred to interpret the detailed regulations and to monitor grant procedures and other matters. Finally, the annual returns (Forms 990-PF, 990-AR and 4720), requiring extensive information, lead to additional accounting costs. A company could eliminate many of these costs by conducting its charitable program directly.[37]

There is one issue that is unique to company foundations – scholarship programs for employees and their dependents. While the regulations adopted under the Tax Reform Act of 1969 provide substantial guidelines for the operation of such scholarship plans by company foundations,[38] the IRS has adopted an administrative position that no grant under such a plan will be a qualifying distribution (and thus not a taxable expenditure) if grants are made to more than 25 percent of the applicants. The rationale is that programs benefitting any greater percentage of the eligible employees are compensatory, rather than chairitable.[39] This results from the

IRS success in *Johnson* v. *Bingler,* 394 U.S. 741 (1969), where the Supreme Court held that monthly payments made by a business corporation directly to employees on educational leave who were required to return to its employ for a commensurate period constituted compensation rather than tax-exempt scholarship payments. The same result has been reached with respect to tuition grants.[40]

The IRS strict approach to company foundation scholarship programs appears to be a misapplication of the *Bingler* rationale. Such programs do not provide a means of evading the *Bingler* consequences on direct payments since it is doubtful that any company foundation would, in view of the self-dealing rules, condition its grants upon continued employment by the company of the recipient or his parent.[41] In addition, while *Bingler* dealt with a monthly substitute for a salary payment and with a former – and future – employee, company foundation scholarship programs involve tuition for qualified dependents of employees and have no relation to the values of the services rendered by the parent-employee. See Revenue Ruling 131, 1953-2 Cum. Bull. 112. (Amounts paid to assist the rehabilitation of employees and their families suffering injuries or property damage from a hurricane were not taxable to the employees because the payments were not related to services but determined by need.) Indeed, the Regulations expressly confer tax-free treatment on one type of educational assistance for employees. Section 1.117-3(a) provides in part:

> If an educational institution maintains or participates in a plan whereby the tuition of a child of a faculty member of such institution is remitted by any other participating educational institution attended by such child, the amount of the tuition so remitted shall be considered to be an amount received as a scholarship.

If a percentage test is to be imposed, it would be appropriate to set it much higher than 25 percent, at, say, 80 percent.[42]

IV

OTHER CORPORATE SUPPORT

Gifts in Kind

In addition to gifts of money, business corporations are an important source of other support. Gifts of equipment and material are important, especially in the scientific fields, since the availability of an item may be more important than its cost. The Red Cross and other relief organizations rely upon business for gifts of medical supplies, food, blankets, and the like. Chemistry, physics, and medical facilities depend upon corporations for gifts of expensive or unique scientific instruments, computers, and other equipment. Vocational training schools receive substantial support in the form of machine tools, demonstration equipment and related materials.

Prior to 1970, corporations were permitted to deduct the fair market value of such gifts. Under present law, the amount of such gifts, for charitable deduction purposes, is limited to the donor's cost in such items.[43] We believe that the deduction provides no real incentive for such gifts. Consideration should be given to permitting a deduction in excess of basis where the availability of the item is essential to the donee's exempt purpose, such as scientific equipment for a college and food and blankets for a disaster relief organization.

Moreover, there currently exists some uncertainty about the relationship of the charitable deduction to the business expense provision. Recent cases evidence some resistance to the Internal Revenue Service's apparent position that the charitable deduction is limited to instances of "disinterested generosity." But these cases also indicate that the Service may take the position that a particular transfer is too connected with the donor's business to constitute a charitable contribution, but so unusual as to fail to qualify as an ordinary and necessary business expense.[44] This uncertainty inhibits desirable innovations in corporate giving.

Personal Services

Business corporations are a very substantial source of personal services for charities. This takes many forms. It includes financial, scientific, engineering and similar technical personnel who are loaned, salary paid, to charitable and educational organizations for definite periods of time. It also includes corporate executives who participate in operating organizations, fund drives, and study panels, such as the Committee for Economic Development, on a largely after-hours basis.

The value of volunteers affiliated with corporations to charitable organizations is immeasurable. The United Way community fund organizations alone estimated they had 20 million volunteers in 1974.[45] The 1972 insurance industry survey of 131 companies estimated that 48,044 employees were involved in community or civic work, with about 4,300 released during normal business hours for volunteer work and 156 loaned to government or community agencies full time with the company paying their compensation.[46]

The charitable income tax deduction does not extend to gifts of services. While salaries of such employees are ordinarily taken as business expense deductions, they would also be deductible by employers as an indirect contribution in the same way that the parking and other out-of-pocket costs of a volunteer are deductible. And, there is probably little abuse. The employer, even with the salary deduction, still pays more than half of the cost. Substantial administrative problems would be presented by efforts to allocate salaries between business and charitable work, especially when after-hours time is used. Motives for undertaking such work are often mixed, involving considerations of community welfare and detached generosity, as well as company presence, publicity and good will, and personal advancement.

The real problem with contributed services is the inability of the self-employed, including partnerships, and the employee pursuing his own charitable work to obtain similar treatment. They are limited to their out-of-pocket costs, such as transportation, incurred in connection with rendering services to charity.

Corporations contribute in other ways, such as making donations to match those of its employees and organizing work-study plans, teacher assistance, and a variety of programs tailored to specific corporate assets and charitable need.

V

CORPORATE GIVING: PART OF CORPORATE SOCIAL RESPONSIBILITY

Most of this report deals with outright gifts for purposes that are clearly charitable in the traditional sense. Increasingly, however, business corporations make expenditures and take actions involving their business activities that take into account considerations of public need and benefit which are very similar to those involved in a program of charitable giving. These actions range from decisions to modify products in view of environmental concerns to decisions to invest in ghetto areas and to hire and train minority workers.[47] Are [illegible] part of a corporation's program of charitable giving?

The answer, of course, depends substantially on the details of the particular individual program involved. However, there seems to have developed a larger concept – often referred to as "corporate social responsibility" – of which charitable giving is only a part. For example, we find the following statement of the purposes of a program – one presumably consistent with corporate responsibility to policyholders and shareholders – under which the life insurance industry committed $2 billion to urban housing and employment-creating enterprises during the period 1967-1972:

> The premise of the program, born of the studies and analyses into urban blight and disorder in the mid-1960s, held that the inner cities were not attracting investment capital needed to slow and reverse their physical and social deterioration. The response of the life insurance companies was a pledge to make investments that they would not have undertaken under normal standards because of location, risk, or yield. Because the life insurance business has an important stake in safe and healthy urban areas, the program was viewed as *a business response to a business problem* and *not as a philanthropic enterprise.* [Emphasis added][48]

The same life insurance group reports on involvement in community projects, employment of women and minority groups, environmental impact actions and investments – together with company contributions and individual voluntarism – under the rubric of corporate social responsibility.[49] Similarly, a Senate subcommittee study on corporate responsibility lumps together efforts for product safety, environmental protection, consumer education and consumer services with public service legal contributions, public broadcasting contributions, and similar charitable efforts.[50]

Some of these activities, such as support of public broadcasting and public legal services, doubtlessly represent new applications of traditional concepts of corporate giving. Others represent new standards for what constitutes acceptable business conduct or new principles of social-cost allocation. In any event, it is clear that the concept of corporate giving is expanding and that a rationale for corporate philanthropy must be equally dynamic.

VI

A RATIONALE FOR CORPORATE PHILANTHROPY

Accommodation of the conflicting economic demands and responsibilities of the business corporation, its customers and rate-payers, its shareholders and its community is not easy. The legal standards adopted in the *Smith* case and most statutes only mark the outer boundaries: First, a business corporation *may* contribute to the community notwithstanding the absence of a direct benefit. Second, there must be some nexus between the donor and the contribution or, perhaps better put in the negative, the contribution must not be made primarily to further the individual purposes of the corporate managers. A universal guide is needed, however.

The following excerpts illustrate efforts to adopt a thorough rationale for corporate contributions.

Dr. Alfred C. Neal, "A More Rational Basis for Nonprofit Activities," 5 The Conference Board Record (January 1968) pp. 5-7.[51]

"In the classical system of economic thought, a company's objective is to maximize its profit; it has nothing to give away. Philanthropy, like politics, is a personal matter. The business pays what it must–as little as possible–for what it buys or uses and returns a profit to the owners who in turn engage in such philanthropy as they choose. A number of economists and businessmen still subscribe to this view.

"With the separation of control from ownership and the growth of companies to very large size, and with the income and inheritance taxes restricting the number of very wealthy individuals, corporate management became concerned with its social responsibilities. The power and wealth of the company became very apparent; the power and wealth of the individual became less important. But social needs remained. Managers, being human and having consciences, could not remain blind to disease, crime, injustice, poverty, and ignorance. The individual conscience and humanity of management could be transferred to the company as an expression of company social responsibility.

"The 'social responsibility' theory, at least in my view, derives in considerable measure from this type of motivation, and I know a number of corporate executives who think in these terms. It is a theory that must be invoked to support some types of corporate philanthropy, but it is to me an intellectually unsatisfying one. If it can be included in the so-called 'prudential' theory, I will be relieved.

"Another theory can be developed out of a realistic appraisal of the pressures for participation in philanthropic endeavors that are felt by companies. I prefer to call this a 'Political Theory of Corporate Nonprofit Activity.' It derives from such corporate objectives as protecting the investment; earning the good will of the community; and achieving better relations with labor, customers, and other interest groups. Corporate powers are exercised with the consent of those who are subject to them. Nonprofit activities are supported to assure the good will of groups and interests whose favor is essential to the continued existence and growth of the company and the freedom of management to manage. I hardly need emphasize that this objective is a very real one and that it can never be totally ignored. It is the basis for much corporate activity these days to improve conditions in our core cities.

"There is, however, a third theory that can be made to encompass virtually all objectives. It derives from the maximum benefit-to-cost notion—the 'prudential investment' theory. It is the corollary, in the nonprofit area, of the profit-maximizing formula for classical economics. Benefits consist of objectives successfully pursued: protection of investment, better employee health and education, community and labor good will, a neighborhood that is attractive to executives. These benefits, in the end, become part of the intangible assets of the company. . ."

Richard Eells, "A Philosophy for Corporate Giving," 5 The Conference Board Record (January 1968) pp. 14, 16-17.[52]

"During the past decade, there have been two different approaches to this philosophy of corporate giving. Some say that the real motivation for corporate giving is and should be entirely philanthropic—done, that is to say, for the love of mankind alone, and completely as a public service. Others say that corporate giving is a matter of straight business expediency and therefore a completely self-regarding act. There are variations of these extreme positions, as well as modified views in between. There is a good deal of truth in some of these positions, but probably the whole truth in none of them.

"The prudential basis of the donative rationale has always appealed to me as the most reliable one in the long run. By the prudential theory I mean that managerial reasoning for *good donative decision-making has to do with good business practice far more than with philanthropy*. Corporate giving should not, I think, be governed mainly by philanthropic principles but rather by the principles of prudent corporate management. Managers should certainly take every deduction that the law allows for gifts made from corporate funds, but these gifts are justifiable mainly because there are good reasons for such expenditures in the pursuit of a company's business objectives. The business objectives of corporations must not, of course, be narrowly limited to profit-maximization alone.

"There are similarities between this theory and a general theory of prudential investment of corporate assets. Long-term benefits from wise investment—say in research and development—are certainly within the range of good and rational business practice by responsible corporate managers. Yet this term "prudential" as applied to corporate giving has been questioned on the ground that it calls up antiquated economic theory. To base corporate giving on prudential grounds, it has been argued, is to elevate the pursuit of corporate gain erroneously to the level of noble action in the public interest, much as the conventional wisdom in economics had seen the wondrous work of the invisible hand in an economy of shopkeepers.

"This allegation of wrong-headed economics as the basis for a prudential theory of corporate giving is of course misdirected. A prudential theory of corporate giving is not rooted in an economics of corporate selfishness. It must be conceded, furthermore, that there is a substantial corpus of legal reasoning to substantiate managerial donative action on straight philanthropic grounds. We should all welcome this happy development. This legal reasoning can very well form a part of the rationale of corporate giving. But not the most important part. For corporate giving, which I believe to be far below what it ought to be both in dollar amounts and the things supported, ought to stand logically on its own feet. It needs to be justified in its own terms as an appropriate *corporate* function, and should not merely follow on the tail of public policy. . .

"As business has come to be regarded as a profession and the corporation as a major social institution of our time, there is also a strong trend toward the idea that corporate 'social responsibility' demands corporate giving. It is sometimes said that this responsibility theory competes with the view of corporate giving on prudential grounds.

"The prudential approach requires those who do donative work to begin with the company's purposes, its aims as a business, and to consider each donative proposal as a means toward one or more of these ends. Corporate giving can sometimes be shown to be a very good, often the very best, way to achieve a company's *business* objectives. Nor must it for one moment be conceded that this linkage necessarily means pursuit of corporate self-interest at the expense of public interest. Both can be served.

"But under the responsibility theory of corporate giving, one is likely to begin with completely exterior considerations—with reference, for example, to those on the outside to which a company presumably owes responsibilities—and then to seek a linkage of logic with company interests, if indeed any such linkage is sought at all. It is quite appropriate to begin and end the logical process with reference to the external institutions in foundation philanthropy. But not, I think, in the donative work by a company component. (A foundation is a non-business entity.). . ."

W. Homer Turner, "The Societal Role of the Corporations," 5 The Conference Board Record (January 1968) pp. 11, 13.[53]

"The corporation has been responding historically to five *internal* pressures. These have been, and continue to be, those from (1) stockholders for dividends, (2) employees (and their unions) for working compensation and other benefits, (3) governments for taxes, (4) customers for quality goods and services, and (5) suppliers for purchase of their materials and equipment. To these five forces, under today's conditions and as a large part of the private sector, corporation managers must now reckon with a sixth pressure. It is to save some part of the cash flow for the not-for-direct-profit eleemosynary institutions. The role of management is to balance out these claims prudently, including the newer claim for contribution aid or philanthropic grants by thousands of units serving societal needs. Contribution aid and philanthropic grants must be neither too large nor too small, and always timely, if a healthy enterprise is to continue to be sanctioned.

"And where do sanctions come in? They arise from six *external* forces. Four of these are (1) the millions of units comprising the family, (2) the varieties of spiritual experience represented by the church, (3) the state and its subdivisions as going institutions, and (4) the total economy including all the rest of economic effort beyond that of the corporations. These four–family, church, state, economy–are catalyzed by two other basic institutions, one designed for education and training, and the other (for fueling the whole of our changing society) science and technology. It is the medley of the six, the total public as the composite electorate which sanctions and continues, halts or inhibits the life of the corporation as a social norm, and lays down rules affecting the right to manage risked capital on an incentive enterprise basis.

"Common prudence requires appropriate actions, to the degree commensurate with a corporation's position and resources, to assist the march toward desirable social goals. Although no certainty can exist, it appears reasonable to suppose that the corporation which is expert and alert in dealing with all these internally and externally posed forces is the more likely to receive the needed sanctions to continue to produce goods and services profitably with the needed freedom of action. . ."

W.J. Baumol, "Enlightened Self-Interest and Corporate Philanthropy," *Foundations, Private Giving and Public Policy: Report and Recommendations of the Commission on Foundations and Private Philanthropies* (University of Chicago Press, 1971) pp. 262, 274-275.

(Mr. Baumol suggests that a way to increase corporate contributions is cooperative corporate action. As a background, he notes that (1) corporations seek some benefit from their contributions, and (2) contributions purchase what economists call "public goods"–items whose benefits flow to others as well as the direct consumer.)

"The consequence is another difficulty that characterizes the supply of all public goods. The company that makes a contribution toward their provision is, strictly speaking, not acting in accord with its own interest. The term *enlightened self-interest* is a euphemism which refers to a compound of facts: the public pressures for a 'socially responsible' stance on the part of the firm, the social conscience of management, and its hope that its own contribution will serve as an example to others. Yet as with other public goods, the output of these philanthropic services is likely to be well below what is optimal from the point of view of all companies taken together. Each one of them by itself will finance far fewer of such activities than it would wish to do if all other enterprises were to undertake to match its contributions.

"In this the firm is the victim of what has been described as 'the tryanny of the small decision.' Each company knows that its own contribution can make little difference to, for example, the overall future of higher education. If others fail to contribute, our firm alone cannot save the private universities, while if others do provide sufficient funding, our company's benefaction will not add very much. The net result is that education will not receive as much from industry as it is in the interests of private enterprise as a whole to contribute.

"The resolution to the dilemma may perhaps be found by taking a lesson from other public-good cases. The consortium of business donors may go far in dealing with the difficulty. Consider a group of firms which benefit from the presence of a regional theater in their community. If those companies form an association in which each pledges to bear its share of the deficit of the theater, provided all other members also do so, then the connection between the outlay and the return will become a direct one. The externalities will have been internalized. Each management will indeed be able to say to its stockholders that the outlay is a simple matter of economics and self-interest. Moreover, the cost incurred by each will be small, but the effectiveness of its contribution in preserving the activities of the theater will be very substantial. . ."

VII

RECOMMENDATIONS

Changing Concepts of Charity

A persistent problem is the evolving concept of what constitutes a charitable contribution. While still retaining its core meaning of relief of the distressed and support of the arts and sciences, charity today ranges broadly. In the past efforts to recognize this evolution frequently took the form of adopting statutes or regulations designed to include, and thereby authorize, these developments. But those efforts often lagged behind events; and the statute, when enacted, soon had a limiting effect, tending to freeze a meaning past its prime. A rationale for charity that would avoid this process should be developed.

Corporate Law

Professor Blumberg urges two changes.[54] First, he recommends the adoption of §4(n) of the Model Business Corporation Act to provide clear authority for localized projects of a civic or quasi-governmental nature. That provision would authorize a corporation "to transact any lawful business which the board of directors shall find will be in aid of governmental policy." In addition, Professor Blumberg urges the amendment of §4(m) to read as follows (brackets indicate deleted material; italics indicates additions):

> To make [donations] *expenditures* for the public welfare or for charitable, scientific, [or] educational, *or civic* purposes, *or for the betterment of social, economic, or environmental conditions in any state or other jurisdiction in which the corporation is conducting business or in which its products are sold.*

Regulated Utilities

As the Ohio Citizens' Council for Health and Welfare proceeding indicates (see Appendix A), the status of charitable contributions for rate-making purposes is a significant current issue. The elimination of contributions from the rate base will undoubtedly diminish the funds available from regulated utilities and perhaps provide a rationale for non-regulated companies to follow. There should be developed a rationale for the allowance for rate-making purposes of a reasonable level of charitable contributions.

Tax Considerations

Aside from the treatment of gifts of equipment and other inventory items, some problems of company foundations, and certain technical aspects, the most significant tax aspect is the lack of incentive provided by the charitable deduction. The 5 percent limitation has little actual impact. Consideration should be given to the allowance of credit against a corporation's federal tax liability for charitable contributions. The credit could be available for contributions of all kinds, subject to a specified limitation. Alternatively, the credit could be limited to contributions to certain types of organizations or in support of specified functions. The existing investment tax credit and individual charitable deduction limitations provide suitable structural analogies.

Appendix A

THE PUBLIC UTILITIES COMMISSION OF OHIO

OHIO CITIZENS' COUNCIL FOR)
HEALTH AND WELFARE)
Room 200)
8 E. Long Street)
Columbus, Ohio 43215) *COMPLAINT*
)
vs.)
)
THE PUBLIC UTILITIES COMMISSION)
OF OHIO)

1. The Ohio Citizens' Council for Health and Welfare was organized over 60 years ago, is incorporated under the Ohio non-profit corporation laws and is qualified as a public charity authorized to receive tax deductible contributions pursuant to the Internal Revenue Code. The Citizens' Council encourages and stimulates citizen involvement in the improvement of voluntary and public health, welfare and criminal justice services throughout Ohio. The Citizens' Council receives substantial financial support from United Way campaigns in more than 50 communities throughout Ohio.

2. On November 28, 1973 The Public Utilities Commission of Ohio issued an Opinion and Order in the Matter of the Application of The Cleveland Electric Illuminating Company for Authority to Amend and to Increase its Filed Schedules for Fixing Rates and Charges for Electric Service, Case No. 71-634-Y. After partially disallowing the applicant CEI's charitable contributions as an operating expenditure for rate making purposes during the test year, the PUCO announced the following policy:

> . . .we hereby signal the industry that we are moving towards a policy decision that charitable contributions should not be included at all as an appropriate item for rate base purposes.

3. In announcing this intended change, the PUCO has moved abruptly from a position of more than 25 years during which reasonable charitable contributions were permitted as an operating expense for rate making purposes to a position of not including charitable contributions at all as an appropriate expense and, in so doing, the PUCO has not given due consideration, on the record, to the many implications of this policy change for regulated utilities, for ratepayers and for the communities throughout Ohio who have a stake in this matter. Consequently, the Ohio Citizens' Council, by this Complaint, protests this announced policy change both on its own behalf and on behalf of all other exempt charitable, educational, health, social service and like organizations throughout Ohio.

4. The Ohio Citizens' Council recognizes an obligation on the part of the PUCO to apply an equitable rule in the regulation of charitable contributions as an element in the rate making, but the Citizens' Council believes and avers that the announced policy is arbitrary and unreasonable in failing to take into consideration a number of relevant factors including, but not limited to, the following:

Any PUCO policy which denies reasonable charitable contributions as a legitimate expense for rate making purposes ignores a commitment to the general welfare particularly applicable to a regulated enterprise whose identity with the public interest is inherent in the legislation which gives rise to its existence.

Any PUCO policy which denies reasonable charitable contributions as a legitimate expense for rate making purposes will result in serious financial losses to a wide range of services in such vital areas as health, rehabilitation, youth development, senior citizen concerns, education, child care and human relations and will hamper related charitable organizations having as their basic purpose the alleviation of human needs.

Any PUCO policy which denies reasonable charitable contributions as a legitimate expense for rate making purposes will result in the serious impairment and disruption of the growth and development of essential community facilities dependent on contributions for their construction and maintenance.

Any PUCO policy which denies reasonable charitable contributions as a legitimate expense for rate making purposes, with the resulting inevitable decrease in corporate contributions by utilities, will have a compounding adverse effect upon the contributions of utility employees and other individuals and companies who look to and expect pace setting leadership from utility companies.

Any PUCO policy which denies reasonable charitable contributions as a legitimate expense for rate making purposes tends to reverse the American tradition, firmly embedded in Ohio public policy and practice, that voluntary organizations and the private sector shall maintain a paramount role in discharging social responsibility and in implementing social change.

Any PUCO policy which denies reasonable charitable contributions as a legitimate expense for rate making purposes tends to stifle the evolving partnership between the public and private sector which has become a vital part of national and state policy as most recently reflected in the 75-25, public-voluntary, financing of social services under the Social Security Act.

Any PUCO policy which denies reasonable charitable contributions as a legitimate expense for rate making purposes flies in the face of established public policy, buttressed by tax law and nationwide leadership, that business corporations be encouraged to support charitable endeavors.

Any PUCO policy which denies reasonable charitable contributions as a legitimate expense for rate making purposes places regulated companies at an unfair disadvantage as compared to non-regulated businesses in discharging their community obligations.

Any PUCO policy which denies reasonable charitable contributions as a legitimate expense for rate making purposes tends to deprive regulated companies and their employees of the direct benefits of community services, such as first aid training, which enhance the regulated companies' productivity and ability to serve the consuming public

Any PUCO policy which denies reasonable charitable contributions as a legitimate expense for rate making purposes disregards the interest of ratepayers, as citizens, in assuring that quality services are available as needed by any person in the community.

Any PUCO policy which denies reasonable charitable contributions as a legitimate expense for rate making purposes is without business precedent in according to customer ratepayers a special voice in determining business expenses.

Any PUCO policy which denies reasonable charitable contributions as a legitimate expense for rate making purposes confers no appreciable benefit on ratepayers since the impact on the rate structure is minimal and, on the other hand, by reason of the foregoing considerations, portends serious consequences to ratepayers as citizens and to the communities in which they reside.

5. The Ohio Citizens' Council proposes, as a regulation consistent with the foregoing considerations, and in discharge of the obligation of the PUCO to regulated companies and to the ratepayers and communities these companies serve, the adoption of the following:

The PUCO shall, in any utility rate proceeding, allow charitable contributions as an appropriate item of operating expense for rate making purposes provided such charitable contributions meet the following conditions:

A. *Reasonableness of Expenditure.* The charitable contributions expenditure shall be reasonable in relationship to the size and scope of the company's operations and shall not in any event exceed that amount which is deductible as a charitable contribution for the purpose of determining taxable income of the company for federal income tax purposes.

B. *Public Charitable Recipient.* The recipient of an allowable charitable contribution shall be an organization which qualifies as a "public charity", and, accordingly, is not a "private foundation", within the meaning of Section 509(a) of the Internal Revenue Code of 1954, as amended; that is, such organization shall be a religious, charitable, scientific, literary, educational or other organization which qualifies for exemption under Section 501(c)(3) and which receives a substantial portion of its funds from the general public or otherwise meets the requirements of Section 509(a).

C. *Benefit to the Service Area.* The recipient of an allowable charitable contribution shall be an organization which conducts its activities "in substantial part" within the service area of the company or, in the case of a recipient whose activities transcend the service area, it shall conduct its activities "in substantial part" within the State of Ohio.

D. *Status of Company Foundations.* In order for a charitable contribution to a "private foundation" controlled by the company (a "company foundation"), to be allowable as a charitable expenditure under this regulation, an amount equivalent to such contributions shall be distributed to one or more "public charities", as hereinabove defined, not later than the last day of the year following that in which the company made the contribution to its company foundation, all in accordance with the principles contained in Section 4942 of the Internal Revenue Code.

E. *Contributions in the Nature of Employee Fringe Benefits.* Contributions which do not qualify under the foregoing provisions of this regulation may nevertheless be allowed as an expense for rate making purposes if such contributions qualify as employee fringe benefits, such as, for example, matching gift programs to educational institutions wherein the company matches all or a portion of a voluntary employee contribution or grants to colleges, universities or technical schools, wherever located, if such institution conducts instructional or research programs in subjects related to company interests and where there is a reasonable likelihood that graduates would become employed within the contributing company's service area.

WHEREFORE, the Ohio Citizens' Council prays (a) that the PUCO consider and adopt the foregoing regulation under which qualified charitable contributions by a utility may be allowed as an operating expense for rate making purposes; (b) in furtherance thereof, that a hearing be conducted at an appropriate future date wherein all utility companies and other interested and affected parties may appear and give evidence in response to this Complaint; and (c) that until the disposition of this cause the PUCO suspend further disallowances of charitable contributions in pending rate proceedings.

OHIO CITIZENS' COUNCIL
FOR HEALTH AND WELFARE

By ______________________________
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Appendix B

NEW YORK STATE BAR ASSOCIATION
TAX SECTION

Proposals for Improvement of Rules for Allocation of Deductions Between Foreign and U.S. Source Income (1974) §IX-D, pp. 169-171*

D. Charitable Contributions

The 1966 version of the Proposed Regulation stated in paragraph (a) (3) (vi):

> "The deduction for charitable contributions allowed by section 170 shall be considered a deduction which is not definitely related to any item or class of gross income *unless it was incurred in whole or in material part as a result of, or incident to, the taxpayer's trade or business.* For example, if a corporation, which is engaged in manufacturing activities in city A in the United States and city B in a foreign country, claims a deduction for a contribution to the Community Chest of city A, such deduction shall be considered to be definitely related to the items or classes of gross income generated by its manufacturing activities in city A." (Emphasis added).

Certainly this approach seems more realistic than the one (requiring ratable allocation for all charitable contributions) reflected in the new Proposed Regulation.

Account should also be taken of the fact that the deduction granted by I.R.C. Section 170 for charitable contributions is generally limited to contributions made to U.S. entities. Moreover, the provisions dealing with nonresident aliens and foreign corporations (I.R.C. Sections 873(b) (2) and 882(c)(1)(B) permit such foreign taxpayers to claim a full deduction for charitable contributions allowed by Section 170, without having to apportion such deductions between U.S.-source and foreign-source income. The same is true, as we have seen, under Sections 911[149] and 931(d)(2)(C).[150] These considerations raise the question whether Congress could reasonably have intended that foreign taxpayers (and U.S. taxpayers entitled to the benefits of Sections 911 or 931) should be entitled to attribute their charitable deductions entirely against U.S. taxable income, while all other U.S. taxpayers should be required to apportion their charitable deductions in part to foreign-source gross income (and thereby, in substance, risk loss of part of the tax benefit for the deduction, since it is not likely that the foreign tax system involved would permit a deduction for these items). It seems most unlikely that Congress could have intended this result.

Accordingly, we believe that the proper treatment of charitable deductions under I.R.C. Sections 861-63—and the one most consistent with other pertinent provisions of the Federal income tax statute—is to treat them as being definitely related to U.S.-source income and not as falling within the ratable category.

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*Reprinted in 29 Tax Law Review 597 (1974).

[149] See Reg. §§ 1.911-1(a)(3); 1.911-2(d)(6).

[150] The Proposed Regulation does not indicate how the taxpayer should resolve the conflict between its provisions and the conflicting provision of Section 931, which is an "operative section" for purposes of the Proposed Regulation. Clearly however the statutory provision would prevail (as in the case of the similar provisions of Section 873 and 882, which are expressly recognized by a cross reference in Prop. Reg. § 1.861-8(e)(9)).

Appendix C

BIENNIAL SURVEY OF COMPANY CONTRIBUTIONS*

John H. Watson III

A Research Report From The Conference Board (1973)

Company contributions to health and welfare, education, the arts, and civic and other causes in 1972 showed an increase when compared with 1970, although the gain in corporate earnings outpaced the rise in giving. Consequently, according to the Conference Board's survey of 443 companies, contributions as a percentage of corporate pretax income stood at 0.73% compared with 0.82% for 1970.[1]

The usual tendency for higher rates of giving to prevail among smaller companies was evident in this survey as it was in earlier ones. However, companies with 25,000 and more employees, which made up one fourth of the sample, accounted for two thirds of the contributions reported.

The distribution of the gift dollar among the several categories of beneficiaries remained in much the same proportion as in 1970 despite a slight gain by health and welfare agencies. The most significant change reported in the allocation of the $323 millions in grants was a marked reduction in capital giving in all areas of support.

Grants by company foundations as opposed to direct company grants accounted for 58% of all giving in 1972 as against 60% for 1970. Moreover, 35 of the 223 companies with foundations reported that they made no grant to their foundation during the year (see Table 1). It is too early to say whether the Tax Reform Act of 1969 was a significant factor in these developments.[2]

About This Survey

This survey presents an analysis of company contributions paid out to beneficiaries in the United States during 1972. Based on the experience of 443 companies, it provides data which will enable those in business and industry who are concerned with distribution of the contributions dollar to relate their company's giving to that of other firms of similar size and interests.

Approximately one and a half million corporate income tax returns are filed annually with the Internal Revenue Service. Though the Conference Board's sample of 443 companies is small and is heavily weighted by large companies, the aggregate gifts of $323 million reported by participating companies account for a little more than one third of all company giving; also, the report is unique in that the analysis of the contributions dollar by major areas of support and the presentation of most of the giving ratios are not to be found elsewhere.

For companies with foundations this report includes payments by the company to various causes as well as similar payments made by its foundation. It does not include payments by a sponsoring company to its foundation since such funds may not necessarily reach charitable and philanthropic causes for some time, remaining instead as part of the corpus of the foundation. Thus, Conference Board figures are not necessarily the same as those a company reports to the Internal Revenue Service for tax purposes. Like those statistics, Conference Board estimates include tax deductions taken by companies for gifts of material and equipment.

The number of companies reported in the several tabulations varies for two reasons: (1) cooperators to the survey did not always reply to all questions, and (2) "Net income," as used by industrial companies, is not applicable for insurance companies which are not included in the tables reporting net income.

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*Reprinted with permission of The Conference Board, New York, New York.

[1] The Bureau of Internal Revenue Service estimates corporate contributions for 1972 at 5% above 1970; corporate net income before taxes rose 32% during the same period.

[2] *The Impact of the Tax Reform of 1969 on Company Foundations*, Report No. 595, The Conference Board, 1973.

Table 1

The Company Contributions Dollar, 1972

	443 Companies		220 Companies without Foundation		223 Companies with Foundation	
	Thousands of Dollars	% of Total	Thousands of Dollars	% of Total	Thousands of Dollars	% of Total
Health and welfare						
Federated drives: United Funds and the like	$ 85,951	26.65	$ 38,372	28.50	$ 47,579	25.32
National health agencies (not included above)	3,304	1.02	1,275	.95	2,028	1.08
National welfare agencies (not included above)	5,935	1.84	2,390	1.77	3,545	1.89
Hospitals						
Capital grants	15,974	4.95	6,231	4.63	9,742	5.18
Operating grants	1,919	.59	699	.52	1,219	.65
Other local health and welfare agencies	14,392	4.46	4,652	3.46	9,739	5.18
Capital grants (excluding hospitals)	8,037	2.49	4,041	3.00	3,996	2.13
Total health and welfare	135,514	42.01	57,662	42.82	77,852	41.43
Education						
Higher education						
Scholarships	13,837	4.29	4,993	3.71	8,844	4.71
Fellowships	4,559	1.41	2,135	1.59	2,424	1.29
Research grants (not treated as a business expense)	8,102	2.51	2,998	2.23	5,103	2.72
Capital funds	17,740	5.50	7,264	5.39	10,476	5.58
Direct unrestricted grants	37,299	11.56	18,867	14.01	18,431	9.81
Grants to state, area and national fund-raising groups	8,497	2.63	3,356	2.49	5,141	2.74
Education-related agencies	3,151	.98	999	.74	2,151	1.15
Other	15,341	4.76	4,657	3.46	10,684	5.69
Secondary education						
Capital grants	645	.20	164	.12	480	.26
Other	7,700	2.39	3,659	2.72	4,040	2.15
Total education	116,876	36.23	49,096	36.46	67,780	36.07

Table 1 (Cont.)

Culture (cultural centers, performing arts, museums, etc.)						
Operating funds	10,462	3.24	4,407	3.27	6,055	3.22
Capital grants	2,729	.85	870	.65	1,859	.99
Total cultural	13,192	4.09	5,277	3.92	7,915	4.21
Civic causes (municipal and community improvement, good government, and the like)						
Total civic	29,487	9.14	11,962	8.88	17,524	9.33
Other						
Religious causes	1,293	.40	642	.48	651	.35
Groups devoted solely to economic education	2,318	.72	696	.52	1,621	.86
Groups in U.S. whose principal objective is aid to other countries	3,418	1.06	633	.47	2,784	1.48
Causes other than above	16,604	5.15	7,984	5.93	8,620	4.59
Total "other"	23,634	7.33	9,956	7.39	13,678	7.28
Dollars not identifiable because donee is unknown	3,859	1.20	699	.52	3,159	1.68
Grand Total	322,564	100.00	134,654	100.00	187,910	100.00

The table [entitled "The Contributions Dollar," following Table 11] provides a tabulation of the contributions dollar for each survey beginning in 1959.

Additional Data Upon Request

The storage of these data on the Master Data Base File makes it possible, for a fee, to prepare additional tabulations if requested by Conference Board Associates.

The Rate of Giving

Changes in corporate giving generally parallel changes in company income. Historically, however, fluctuations in contributions are of a smaller magnitude than variations in profits. This pattern is continued in 1972, when the gain in contributions failed to equal the rise in company earnings. Since the annual operating budgets of nonprofit agencies are less volatile in their movement than profits, this pattern of giving offers them a greater degree of stability, particularly when corporate income is falling, than would otherwise be the case.

Table 2 shows that the lowest ratio of contributions to pretax income was 0.68% reported by 87 companies with 25,000 and more employees. This ratio contrasts with 0.87% for companies in the next two smaller categories and 2.40% for firms in the smallest category. However, the magnitude of gift budgets is sharply higher for larger than for smaller companies.

Table 2

Percent of Contributions to Net Income, Before Taxes–Companies Grouped by Number of Employees (Insurance companies excluded)

Company Size by Number of Employees	Number of Cos.	Net Income before Taxes in Thousands	Contrs. in Thousands	% of Contrs. to Net Income
Below 250	8	$ 8,037	$ 192	2.40
250-499	3	7,000	136	1.94
500-999	12	81,311	713	.88
1,000-4,999	96	1,948,033	17,912	.92
5,000-9,999	65	2,541,457	22,021	.87
10,000-24,999	87	6,291,650	54,961	.87
25,000 and over	87	29,179,383	198,276	.68
Total	358	40,056,871	294,211	.73

Understandably, much the same giving pattern obtains when companies are grouped according to assets rather than numbers of employees (see Table 3). It will be seen, however, that among the smaller companies the correlation of gift-income ratios to company size is not as sharp as when the companies are grouped by number of employees.

There are companies in every group that consider themselves to be leaders. Their high propensity to give also makes for wide variations about the average of 0.73%. For example, it is the policy of several companies to give in the neighborhood of 5% annually. According to Table 4, ten companies contributed 5% and more. For Federal income tax purposes, companies can deduct 5% of their pretax income for contributions but are allowed a five-year carry forward. Slightly more than half the companies reporting contributed at a rate of less than 1%, with another 30% setting their budgets between 1% and 2%.

Contributions per Employee

Contributions per employee is another yardstick commonly used for making comparisons. Unlike the ratios discussed above, this measure is applicable to all industry groups including

Table 3

Percent of Contributions to Net Income, Before Taxes–Companies Grouped by Size of Assets (Insurance companies excluded)

Company Size by Assets in Millions	Number of Cos.	Net Income before Taxes in Thousands	Contrs. in Thousands	% of Contrs. to Net Income
Below $15	15	$ 225,180	$ 4,926	2.19
$15–24	4	13,733	135	.99
25–49	12	57,566	972	1.69
50–99	27	282,201	3,672	1.30
100–199	41	729,826	6,566	.90
200 and over	260	38,777,466	278,039	.72
Total	359	40,085,973	294,310	.73

Table 4

Percent of Contributions to Net Income, Before Taxes–Companies Grouped by Rate of Giving (Insurance companies excluded)

% Contributions to Net Income before Taxes	Number of Companies
–1%	190
1–1.99	107
2–2.99	30
3–3.99	12
4–4.99	3
5–5.99	2
6–6.99	1
7–7.99	...
8–8.99	2
Over 9%	5
Total	352[1]

[1] Income deficits were reported by 6 of the 358 companies.

insurance companies. These calculations for companies in various size classes are shown in Table 5.

Highest support per employee is found among the smaller companies,[3] with a tendency for grants to diminish as the size of the company expands. The overall average of $34 is the same as the record high reported in the Board's 1968 survey and compares with $31 for 1970.

An analysis of the firgues for individual companies shows great dispersion about this average. For all reporting companies, gifts per employee ranged from $1.45 to $858.97. The twelve least generous and the twelve most generous donors are depicted in Table 6. It is worth noting that among the most generous companies are three with budgets exceeding $1 million.

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[3] For an analysis of practices in smaller companies see *Corporate Contributions in Smaller Companies*, Report No. 603, The Conference Board, 1973.

Table 5

Contributions Per Employee—Companies Grouped by Number of Employees

Company Size by Number of Employees	Number of Cos.	Number of Employees in Thousands	Contrs. in Thousands	Contrs. per Employee
Below 250	11	1	$ 274	$ 174
250–499	7	2	209	83
500–999	20	14	1,310	88
1,000–4,999	133	344	24,039	69
5,000–9,999	78	564	26,622	47
10,000–24,999	97	1,567	62,739	40
25,000 and over	92	7,011	204,575	29
Total	438	9,506	319,770	34

Table 6

The Twelve Least Generous and Twelve Most Generous Donors—Contributions Per Employee

		Number of Employees	Contributions	Contributions per Employee
		LEAST GENEROUS		
Company	1	2,736	$ 3,982	$ 1.45
	2	5,000	8,000	1.45
	3	14,000	27,000	1.92
	4	17,000	58,337	3.43
	5	3,000	16,000	5.33
	6	1,200	6,991	5.82
	7	5,000	30,750	6.15
	8	8,900	60,963	6.84
	9	11,000	82,000	7.45
	10	14,555	117,020	8.03
	11	57,000	459,000	8.05
	12	34,500	278,200	8.06
		MOST GENEROUS		
Company	1	1,450	$ 1,245,518	$ 858.97
	2	168	77,593	461.86
	3	3,000	1,074,300	358.10
	4	1,255	385,850	307.45
	5	3,750	1,116,672	297.77
	6	2,000	517,641	258.82
	7	1,700	431,000	253.52
	8	200	50,475	252.37
	9	203	51,152	251.98
	10	1,400	345,628	246.87
	11	175	41,620	237.82
	12	1,974	424,714	215.15

Contributions Related to Assets

Contributions as a percentage of a company's assets is yet another yardstick for measuring contributions, though it is employed less frequently than the others. Tables 7 and 7A show these relationships for all participants and for insurance companies only. Although in each instance the highest ratios are to be found in the smallest companies, there is not the same tendency as with the other yardsticks for the ratios to diminish as size of company increases; indeed, there is very little in the way of a pattern when giving is related to assets. In the instance of the insurance companies, whose assets are of an entirely different character from industrial companies, contributions are minuscule when compared with assets.

Table 7

Percent of Contributions to Assets–Companies Grouped by Number of Employees

Company Size by Number of Employees	Number of Cos.	Assets in Thousands	Contrs. in Thousands	% of Contrs. to Assets
Below 250	11	$ 762	$ 274	.04
250–499	7	708	209	.03
500–999	18	6,771	1,097	.02
1,000–4,999	126	98,127	22,310	.02
5,000–9,999	76	110,579	25,778	.02
10,000–24,999	95	193,656	60,249	.03
25,000 and over	91	708,810	203,776	.03
Total	424	1,119,415	313,696	.03

Table 7a

Percent of Contributions to Assets–Companies Grouped by Number of Employees
(Insurance companies only)

Company Size by Number of Employees	Number of Cos.	Assets in Thousands	Contrs. in Thousands	% of Contrs. to Assets
Below 250	3	$ 391	$ 81	.020
250–499	4	674	73	.010
500–999	4	2,503	150	.006
1,000–4,999	23	32,693	3,254	.009
5,000–9,999	9	28,800	3,566	.012
10,000–24,999	8	31,789	5,288	.016
25,000 and over	4	390,638	5,500	.001
Total	55	487,491	17,915	.003

Industry Comparisons

When the cooperating companies are grouped by industry, it is apparent that manufacturing firms give at a higher rate than nonmanufacturers (see Table 8). This is a familiar pattern and is explained by the number of regulated industries in the nonmanufacturing sector. For example, the relatively low rate for public utilities reflects the restrictions of some state regulatory bodies on including the cost of contributions in the computation of the rate base. A rate of 0.83% for manufacturers contrasts with 0.55% for nonmanufacturers.

Table 8

Percent of Contributions to Net Income, Before Taxes–Companies Grouped by Industry Class
(Insurance companies excluded)

Industrial Classification	No. of Cos.	Net Income before Taxes in Thousands	Contrs. in Thousands	% of Contrs. to Income
Chemicals and allied products	33	$ 4,326,122	$ 36,668	.85
Electrical machinery and equipment	21	2,786,588	22,340	.80
Fabricated metal products	25	4,901,686	21,289	.43
Food and kindred products.	18	1,033,114	9,974	.97
Machinery, nonelectrical.	15	2,014,402	19,519	.97
Paper and like products	10	501,967	6,743	1.34
Petroleum refining	15	3,454,333	28,633	.83
Primary metal industries	19	1,010,206	14,828	1.47
Printing, publishing	6	196,595	1,088	.55
Rubber, miscellaneous plastic products	7	268,117	2,187	.82
Stone, clay and glass products	8	360,555	5,077	1.41
Textile mill products	10	193,145	8,122	4.21
Tobacco manufacturers.	2	749,000	2,868	.38
Transportation equipment	11	1,612,824	16,495	1.02
Misc. manufacturing industries	30	2,628,191	20,696	.78
Total: Manufacturing	230	26,036,850	216,536	.83
Banking	40	1,595,902	17,141	1.07
Finance, real estate	6	523,343	3,137	.60
Public utilities	52	7,233,008	31,820	.44
Trade, wholesale and retail	12	4,044,072	18,633	.46
Other nonmanufacturing.	17	625,487	6,684	1.07
Total: Nonmanufacturing	127	14,021,894	77,417	.55
Total: All companies	357	40,058,744	293,954	.73

The highest rate recorded (4.21%) is for the textile group, again as in 1970. The next highest rates prevail among the following groups: primary metals, 1.47%; stone, clay, and glass, 1.41%; paper and like products, 1.34%; and transportation equipment, 1.02%. Among the nonmanufacturers, the banking group leads with a rate of 1.07%.

Labor- vs. Capital-Intensive Firms

One of the basic principles that underlie sound corporate giving postulates that mutual benefits stem from corporate contributions. In helping the community the company is contributing to its own well-being. Since company employees avail themselves of the services of many of the community projects funded by their companies, it is reasonable to assume that labor-intensive firms are on the average more generous donors than capital-intensive firms, other things being equal. Table 9 shows the rate of giving for companies grouped according to number of employees per $1,000 of assets.

Table 9

Percent of Contributions to Net Income, Before Taxes–Companies Grouped by Number of Employees Per $1,000 of Assets (Insurance companies excluded)

Employees per $1,000 of Assets	Number of Cos.	Contrs in Thousands	Net Income before Taxes in Thousands	% of Contrs. to Income
Less than .001	12	$ 8,308	$ 853,961	.97
.0010–.0029	33	10,236	1,259,260	.81
.0030–.0049	28	18,569	3,598,192	.52
.0050–.0069	19	16,913	2,471,270	.68
.0070–.0089	2	883	54,400	1.62
.0090–.0099	5	789	150,011	.53
.010 –.029	109	137,193	16,483,230	.83
.030 –.049	75	58,779	11,368,636	.52
.050 –.069	38	28,436	2,291,925	1.24
.070 –.089	16	7,984	1,229,004	.65
.090 –.099	4	356	27,301	1.31
.1 and over	12	5,543	271,571	2.04
Total	357	293,954	40,058,745	.73

The statistics would seem to bear out this hypothesis, for higher rates of support are generally found among the labor-intensive companies, rising as high as 2.04% among companies having the largest number of employees per $1,000 of assets. Some companies below the mid-point on the scale are, however, contributing at a rate equal to or above those nearer the top.

Beneficiaries of Corporate Support

Who are the beneficiaries of corporate support? Health and welfare, and education together received about three quarters (78%) of the funds budgeted by industry for contributions. Although during the past two surveys each nonprofit segment shared almost equally, health and welfare won 42 cents of the gift dollar in 1972, compared with 36 cents for education. Education's share seems to have stabilized thus far during the Seventies, following two decades during which it was able to command an increasing portion of company gift budgets. As is noted in Table 10, however, the support of both groups is broadly based, with virtually all companies (99%) supporting health and welfare and 97% budgeting funds for higher education.

Civic and cultural programs, areas next in importance, fared about as they did for 1970 with civic causes receiving 9 cents of the gift dollar and culture 4 cents. The balance of 9 cents was distributed to "other" causes as shown in Table 1.

Among the "other" causes are those groups in this country whose principal objective is aid to other countries. Since U.S. business is expanding abroad, a number of companies foresee a growth in support of such groups. A recent Conference Board survey[4] shows an increasing concern among companies for involvement in public service activities and their impact both on themselves and their relationship with host countries.

Health and Welfare

More than half the grants (27 cents out of 42 cents) made to health and welfare are channeled through federated drives. Another 5½ cents goes to hospitals, the next major

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[4] *U.S. Business Support for International Public Service Activities; Part 1: Support from U.S. Headquarters*, The Conference Board, 1973.

Table 10

Frequency of Support in Major Areas of Giving
(443 companies)

Area of Support	Frequency of Company Support
Health and welfare	
Federated drives: United Funds and the like	**98%**
National health agencies (not included above)	**43**
National welfare agencies (not included above)	**37**
Hospitals	
Capital grants	**66**
Operating grants	**38**
Other local hospital and welfare agencies	**76**
Capital grants (excluding hospitals)	**34**
Total health & welfare	**99**
Education	
Higher education	
Scholarships	**56**
Fellowships	**25**
Research grants (not related to business expenses)	**22**
Capital funds	**52**
Direct unrestricted grants	**78**
Grants to state, area, and national fund-raising groups	**52**
Education-related agencies	**41**
Other	**43**
Secondary education	
Capital grants	**9**
Other	**30**
Total education	**97**
Culture	
Operating funds	**75**
Capital grants	**27**
Total cultural	**79**
Civic causes	**83**
Other	
Religious causes	**21**
Groups related solely to economic education	**41**
Groups in U.S. whose principal objective is aid to other countries	**18**
Causes other than above	**56**

recipient. Less than 3 cents is contributed directly to national health and welfare agencies, underscoring industry's preference for local community causes.

Table 11 indicates that nonmanufacturing companies generally devote a larger share of their budgets (54%) to health and welfare than manufacturers (37%). This same tendency is evident among smaller companies (see Tables 12 and 13). Table 12A, which reports on insurance companies only, reveals that one half (52%) of their budget is directed at health and welfare.

Table 11

Beneficiaries of Company Support–Companies Grouped by Industry Classification

Industry Classification	Number of Companies	Total Giving in Thousands	HEALTH AND WELFARE: United Funds	National Health	National Welfare	Hospital Capital Grants	Hospital Operating Grants	Local Agencies	Misc. Capital Grants	Total Health & Welfare
			Percentage Distribution							
Chemicals and allied products	37	$ 40,795	18.7	2.1	2.2	3.0	.7	2.6	1.2	30.5
Electrical machinery and equipment	21	22,343	27.6	.3	.7	5.0	.3	3.0	2.4	39.3
Fabricated metal products	26	21,369	23.8	.4	.9	3.8	.5	3.7	2.6	35.6
Food and kindred products	20	10,137	21.5	1.0	5.9	2.8	.6	6.7	2.0	40.5
Machinery, nonelectrical	16	19,651	19.0	1.0	1.9	9.3	.2	4.1	2.7	38.1
Paper and like products	12	6,883	22.4	.5	1.2	3.0	.5	5.2	1.5	34.3
Petroleum refining	16	29,407	17.1	1.0	.9	2.7	.5	3.8	.7	26.6
Primary metal industries	20	15,283	29.2	2.2	.8	6.8	.4	3.6	1.6	44.5
Printing, publishing	6	1,088	25.9	.8	5.4	7.7	1.3	11.9	3.5	56.5
Rubber and miscellaneous plastic products	7	2,187	38.1	.7	1.2	7.9	.6	1.8	—	50.3
Stone, clay, and glass products	8	5,077	19.7	1.5	7.1	5.4	.5	9.5	.7	44.4
Textile mill products	10	8,122	5.9	.6	1.8	20.0	.3	1.0	.3	29.8
Tobacco manufactures	2	2,868	13.0	.2	5.9	1.1	.4	4.0	—	24.6
Transportation equipment	11	16,496	24.1	.2	.7	3.4	.3	6.8	10.6	46.1
Miscellaneous manufacturing industries	39	21,783	30.2	1.8	1.9	5.4	1.6	4.8	1.2	47.0
Total: Manufacturing	251	223,492	22.0	1.1	1.8	5.1	.6	4.0	2.2	36.9
Banking	44	17,535	36.5	.7	.8	4.3	1.0	4.5	1.4	49.2
Insurance	57	20,668	31.9	1.5	4.3	3.8	.7	4.3	4.5	50.9
Finance, real estate	6	3,137	33.1	1.4	3.4	2.6	1.5	7.7	1.2	51.0
Public utilities	53	31,923	45.4	.5	1.6	6.3	.6	2.8	5.3	62.5
Trade, wholesale and retail	12	18,633	36.9	.3	.9	3.7	.1	10.9	.1	52.8
Other nonmanufacturing	20	7,174	18.7	1.2	2.9	2.5	.7	7.9	2.2	36.0
Total: Nonmanufacturing	192	99,072	37.1	.8	2.0	4.6	.6	5.4	3.1	53.6
Total: All companies	443	322,564	26.6	1.0	1.8	5.0	.6	4.5	2.5	42.0

1885

1886

Table 11 (Cont.)

Beneficiaries of Company Support–Companies Grouped by Industry Classification

Industry Classification	EDUCATION										
	Scholarships	Fellowships	Research Grants	Capital Funds	Direct Unrestricted Grants	Indirect Unrestricted Grants	Education-related Agencies	Other	Secondary Education Capital Grants	Secondary Education Other	Total Education
	Percentage Distribution										
Chemicals and allied products	2.9	2.9	3.3	7.0	20.1	2.4	1.1	4.6	—	2.2	46.6
Electrical machinery and equipment	6.0	.3	7.6	3.4	18.6	2.2	1.0	5.6	.1	.6	45.4
Fabricated metal products	9.4	.5	2.2	4.0	2.3	2.8	.2	11.0	—	12.4	44.7
Food and kindred products	3.8	1.4	1.7	5.2	9.7	3.2	1.9	2.0	.4	1.6	31.1
Machinery, nonelectrical	1.7	3.4	4.6	10.5	19.0	2.9	1.4	.6	.1	.1	44.3
Paper and like products	6.2	1.5	.6	2.9	5.8	2.7	1.4	1.3	—	8.4	30.9
Petroleum refining	6.5	1.4	4.7	5.0	9.7	1.6	.7	18.3	—	.9	48.7
Primary metal industries	7.5	2.8	4.0	7.8	6.1	3.3	2.5	3.7	—	.5	38.2
Printing, publishing	4.9	—	.6	4.8	14.3	2.4	.8	1.5	—	.5	29.8
Rubber and miscellaneous plastic products	6.5	—	3.7	9.7	4.1	9.1	.9	4.0	.1	.3	38.3
Stone, clay, and glass products	4.7	1.5	.6	8.2	2.4	1.6	.1	5.0	.6	.6	25.3
Textile mill products	3.4	.1	.6	11.7	3.7	2.2	.8	4.1	3.4	1.3	31.3
Tobacco manufactures	8.8	—	4.5	18.7	3.9	6.1	—	2.3	—	—	44.3
Transportation equipment	5.1	.1	1.3	4.7	13.1	1.8	.3	2.0	—	9.0	37.5
Miscellaneous manufacturing industries	5.0	3.8	.7	3.0	10.6	4.9	1.3	[illegible]	.1	.2	32.3
Total: Manufacturing	5.2	1.8	3.3	6.0	12.0	2.8	1.0	5.1	.2	2.9	41.4
Banking	.7	.4	.9	7.2	7.9	1.1	1.5	2.6	.2	4.3	25.8
Insurance	3.7	.4	.8	4.2	10.6	3.0	.7	1.5	.4	.9	26.2
Finance, real estate	7.2	.2	—	.8	12.9	.6	1.6	3.0	—	.9	27.1
Public utilities	1.6	.2	.7	5.7	9.3	2.8	.3	1.7	.1	.3	22.7
Trade, wholesale and retail	.5	—	.1	.2	13.4	1.3	1.3	1.4	—	—	18.4
Other nonmanufacturing	6.2	4.1	3.1	3.9	13.3	4.9	1.0	2.8	.5	2.1	41.9
Total: Nonmanufacturing	2.2	.5	.8	4.3	10.5	2.3	.9	1.7	.2	1.2	24.7
Total: All companies	4.3	1.4	2.5	5.5	11.6	2.6	1.0	4.8	.2	2.4	36.2

Table 11 (Cont.)

Industry Classification	Culture Operating Funds	Culture Capital Funds	Total Culture	Civic Causes	OTHER AREAS					
					Religious Causes	Economic Education	Other Country Groups	Other Causes	Total Other	Donee Unknown
					Percentage Distribution					
Chemicals and allied products	3.0	.5	3.6	6.9	.3	.9	5.6	4.1	11.0	1.5
Electrical machinery and equipment	1.8	.5	2.3	3.5	.1	.8	.7	4.1	5.7	3.9
Fabricated metal products	1.5	.3	1.9	9.0	.1	.5	.4	7.8	8.8	.1
Food and kindred products	2.2	3.0	5.3	14.8	.4	1.2	.1	4.6	6.3	2.0
Machinery, nonelectrical	2.0	.6	2.6	11.3	.2	.2	.8	1.8	2.9	.6
Paper and like products	1.4	.3	1.7	6.4	.2	.7	.1	25.4	26.4	.4
Petroleum refining	3.6	.4	4.0	7.5	.1	.8	.8	11.4	13.0	.1
Primary metal industries	3.6	.6	4.2	5.3	.2	.5	.4	6.6	7.8	—
Printing, publishing	2.0	1.2	5.2	5.8	1.0	.3	.6	.6	2.5	.1
Rubber and miscellaneous plastic products	1.3	—	1.3	5.3	.1	1.8	.2	1.7	3.8	1.0
Stone, clay, and glass products	13.3	.8	14.1	13.3	.1	.9	.1	1.7	2.8	—
Textile mill products	1.7	.5	2.2	33.8	1.3	.1	—	.2	1.6	1.3
Tobacco manufactures	2.8	.1	2.9	5.1	.4	.1	—	22.5	23.0	—
Transportation equipment	2.5	.1	2.6	6.3	—	1.2	.6	3.9	5.8	1.7
Miscellaneous manufacturing industries	5.0	.6	5.6	8.5	.7	.7	.5	2.5	4.4	2.2
Total: Manufacturing	3.0	.6	3.6	8.6	.3	.7	1.4	5.9	8.3	1.3
Banking	4.7	1.7	6.4	13.1	.6	.9	.7	1.9	4.1	1.5
Insurance	2.3	1.2	3.4	12.8	.1	.4	.1	5.2	5.8	.9
Finance, real estate	4.1	—	4.2	10.4	2.3	.4	.4	3.4	6.4	.9
Public utilities	3.1	.9	4.1	4.7	1.3	.5	—	3.7	5.5	.6
Trade, wholesale and retail	5.5	2.9	8.4	14.1	.1	1.1	.1	3.1	4.4	1.9
Other manufacturing	4.4	.2	4.7	12.4	.3	1.1	.6	2.7	4.8	.2
Total: Nonmanufacturing	3.8	1.4	5.2	10.4	.7	.7	.2	3.5	5.1	1.1
Total: All Companies	3.2	.8	4.1	9.1	.4	.7	1.1	5.1	7.3	1.2

The Contributions Dollar

	1972 443 Companies		1970 401 Companies		1968 401 Companies	
	Thousands of Dollars	% of Total	Thousands of Dollars	% of Total	Thousands of Dollars	% of Total
Health and welfare						
Federated drives: United Funds and the like	$ 85,951	26.65	$ 74,168	24.07	$ 57,257	21.74
National health agencies (not included above)	3,304	1.02	3,146	1.02	4,210	1.60
National welfare agencies (not included above)	5,935	1.84	3,929	1.27	4,882	1.83
Hospitals						
Capital grants	15,974	4.95	17,156	5.56	15,210	5.78
Operating grants	1,919	.59	2,404	.78	1,564	.59
Other local health and welfare agencies	14,392	4.46	10,346	3.36	9,462	3.59
Capital grants (excluding hospitals)	8,037	2.49	7,721	2.51	5,317	2.02
Total health and welfare	135,514	42.01	118,872	38.57	97,840	37.15
Education						
Higher education						
Scholarships	13,837	4.29	13,787	4.47	10,212	3.88
Fellowships	4,559	1.41	4,539	1.47	4,802	1.82
Research grants (not treated as a business expense)	8,102	2.51	6,711	2.18	8,761	3.33
Capital funds	17,740	5.50	20,123	6.53	25,289	9.60
Direct unrestricted grants	37,299	11.56	32,580	10.57	26,948	10.23
Grants to state, area and national fund-raising groups	8,497	2.63	7,418	2.41	5,884	2.23
Education-related agencies	3,151	.98	3,345	1.08	3,376	1.28
Other	15,341	4.76	18,113	5.87	11,189	4.25
Secondary education						
Capital grants	645	.20	1,138	.36	453	.17
Other	7,700	2.39	8,233	2.67	5,294	2.01
Total education	116,876	36.23	115,990	37.64	102,208	38.81

The Contributions Dollar (Cont.)

Culture (cultural centers, performing arts, museums, etc.)						
Operating funds	10,462	3.24	7,903	2.56	5,750	2.18
Capital grants	2,729	.85	8,505	2.76	7,299	2.77
Total cultural	13,192	4.09	16,408	5.32	13,049	4.95
Civic causes (municipal and community improvement, good government, and the like)						
Total civic	29,487	9.14	25,098	8.14	18,946	7.19
Other						
Religious causes	1,293	.40	1,020	.33	1,952	.74
Groups devoted solely to economic education	2,318	.72	1,970	.64	1,388	.53
Groups in U.S. whose principal objective is aid to other countries	3,418	1.06	5,171	1.68	10,738	4.08
Causes other than above	16,604	5.15	16,787	5.45	13,296	5.05
Total "other"	23,634	7.33	24,949	8.10	27,374	10.39
Dollars not identifiable because donee is unknown	3,859	1.20	6,845	2.22	3,968	1.51
Grand total	322,564	100.0	308,165	100.0	263,387	100.0

1889

The Contributions Dollar (Cont.)

	1965 540 Companies		1962 465 Companies		1959 280 Companies	
	Thousands of Dollars	% of Total	Thousands of Dollars	% of Total	Thousands of Dollars	% of Total
Health and welfare						
Federated drives: United Funds and the like	$ 50,558	24.2	$ 39,280	25.5	$ 25,450	25.1
National health agencies (not included above)	3,176	1.5	2,183	1.4	1,520	1.5
National welfare agencies (not included above)	4,043	1.9	4,114	2.7	3,340	3.3
Hospitals						
Capital grants	17,172	8.2	9,369	6.1	9,330	9.2
Operating grants	2,018	1.0	1,016	.7	1,410	1.4
Other local health and welfare grants	5,301	2.5	5,140	3.3	2,830	2.8
Capital grants (excluding hospitals)	4,653	2.2	2,002	1.3	1,820	1.8
Total health and welfare	86,921	41.8	63,104	40.9	45,700	45.1
Education						
Higher education						
Scholarships	10,569	5.0	7,832	5.1	4,860	4.8
Fellowships	4,715	2.3	4,271	2.8	4,050	4.0
Research grants (not treated as a business expense)	5,073	2.4	4,040	2.6	3,440	3.4
Capital funds	15,180	7.3	9,695	6.3	9,930	9.8
Direct grants	20,487	9.8	18,813	12.2	8,010	7.9
Grants to state, area and national fund-raising groups	7,068	3.4	4,791	3.1	2,830	2.8
Education-related agencies	3,741	1.8	1,793	1.2	1,310	1.3
Other	8,513	4.1	9,740	6.3	3,340	3.3
Secondary education						
Capital grants	765	.4	537	.3	100	.1
Other	4,233	2.0	3,019	2.0	1,720	1.7
Total education	80,344	38.4	64,531	41.9	39,590	39.1

1890

The Contributions Dollar (Cont.)

Culture (cultural centers, performing arts, museums, etc.)						
Operating funds	3,332	1.6				
Capital grants	2,501	1.2				
Total cultural	5,833	2.8				
			8,239	5.3	2,940	2.9
Civic causes (municipal and community improvement, good government, and the like)						
Total civic	12,099	5.8				
Other						
Religious causes	1,053	.5	589	.4	400	.4
Groups devotud solely to economic education	1,788	.9	1,756	1.1	1,520	1.5
Groups in U.S. whose principal objective is aid to other countries	7,868	3.8	2,726	1.8	500	.5
Causes other than above	8,474	4.0	10.856	7.1	7,200	7.1
Total "other"	19,183	9.2	15,927	10.3	9,630	9.5
Dollars not identifiable because donee is unknown	4,916	2.3	2,341	1.5	3,540	3.5
Grand Total	209,296	100.0	154,142	100.0	101,400	100.0

Table 12

Beneficiaries of Company Support–Companies Grouped by Number of Employees

Company Size by Number of Employees	Number of Companies	Total Giving in Thousands of Dollars	HEALTH AND WELFARE: United Funds	National Health	National Welfare	Hospital Capital Grants	Hospital Operating Grants	Local Agencies	Misc. Capital Grants	Total Health & Welfare
			Percentage Distribution							
Below 250	11	$ 274	25.3	1.2	.2	.6	—	4.5	.6	32.4
250–499	7	209	18.0	2.2	1.1	1.5	4.1	4.6	4.3	35.8
500–999	20	1,310	33.3	1.3	.6	10.1	2.1	3.9	3.1	54.3
1,000–4,999	133	24,039	30.9	.5	1.0	5.1	1.2	4.5	2.4	45.5
5,000–9,999	78	26,622	31.2	2.0	1.9	4.9	1.5	4.8	1.7	48.0
10,000–24,999	97	62,739	23.3	1.6	3.1	5.6	.9	5.3	1.4	41.3
25,000 and over	92	204,575	26.4	.8	1.6	4.8	.3	4.2	3.0	41.0
Total	438	319,770	26.6	1.0	1.9	5.0	.6	4.5	2.5	42.0

Company Size by Number of Employees	EDUCATION: Scholarships	Fellowships	Research Grants	Capital Funds	Direct Unrestricted Grants	Indirect Unrestricted Grants	Education-Related Agencies	Other	Secondary Education Capital Grants	Other Secondary Education	Total Education
					Percentage Distribution						
Below 250	2.9	—	—	.1	20.0	.8	2.0	3.6	—	2.3	31.8
250–499	12.3	—	—	1.1	9.3	3.2	2.4	.3	.8	2.8	32.1
500–999	3.7	.8	1.3	7.7	5.1	.4	.8	[illegible]	1.5	.7	27.8
1,000–4,999	4.4	2.7	1.6	5.4	8.6	1.7	1.1	2.1	.2	1.2	29.0
5,000–9,999	5.3	.8	2.2	5.3	10.3	3.1	1.0	2.8	.5	1.3	32.5
10,000–24,999	3.9	1.1	.8	7.4	8.8	2.8	1.3	3.3	.7	1.0	31.0
25,000 and over	4.3	1.4	3.2	5.0	13.0	2.7	.9	5.8	—	3.1	39.4
Total	4.3	1.4	2.5	5.5	11.6	2.7	1.0	4.8	.2	2.4	36.3

Table 12 (Cont.)

Company Size by Number of Employees	Culture Operating Funds	Culture Capital Funds	Total Culture	Civic Causes	OTHER AREAS					Donee Unknown
					Religious Causes	Economic Education	Other Country Groups	Other Causes	Total Other	
					Percentage Distribution					
Below 250	6.5	.3	6.8	11.7	1.7	.8	.1	14.7	17.3	—
250–499	7.1	1.2	8.3	5.0	12.6	1.3	1.0	3.8	18.8	—
500–999	3.7	.4	4.0	12.2	1.8	.7	.1	2.7	5.3	.4
1,000–4,999	3.7	1.9	5.6	14.4	.5	.6	.2	3.4	4.7	.8
5,000–9,999	2.7	.9	3.6	9.9	.3	.8	.5	2.7	4.2	1.7
10,000–24,999	3.6	.9	4.6	11.2	.7	.7	3.6	5.0	10.0	1.9
25,000 and over	3.1	.7	3.9	7.5	.3	.7	.5	5.7	7.2	1.0
Total	3.3	.9	4.1	9.0	.4	.7	1.1	5.1	7.3	1.2

Table 12a

Beneficiaries of Company Support–Companies Grouped by Number of Employees
(Insurance companies only)

Company Size by Number of Employees	Number of Companies	Total Giving in Thousands of Dollars	HEALTH AND WELFARE: United Funds	National Health	National Welfare	Hospital Capital Grants	Hospital Operating Grants	Local Agencies	Misc. Capital Grants	Total Health & Welfare
			Percentage Distribution							
Below 250	3	$ 81	28.2	1.9	.1	.6	—	4.9	2.1	37.8
250–499	4	73	29.7	2.3	.7	2.1	4.2	7.2	8.1	54.3
500–999	4	150	49.3	3.0	—	3.7	6.6	1.9	—	64.6
1,000–4,999	23	3,254	35.7	.8	.6	2.9	1.0	5.0	3.3	49.4
5,000–9,999	9	3,566	35.1	2.1	1.0	3.3	.8	3.3	.6	46.2
10,000–24,999	8	5,288	27.6	1.5	13.5	4.9	.3	4.2	3.0	55.1
25,000 and over	5	6,299	27.4	1.9	1.8	4.9	1.0	5.7	9.9	52.7
Total	56	18,714	30.5	1.7	4.7	4.2	.8	4.7	4.9	51.6

Company Size by Number of Employees	EDUCATION: Scholarships	Fellowships	Research Grants	Capital Funds	Direct Unrestricted Grants	Indirect Unrestricted Grants	Education Related Agencies	Other	Secondary Education Capital Grants	Other Secondary Education	Total Education
					Percentage Distribution						
Below 250	—	—	—	.4	41.6	—	—	5.7	—	.2	48.0
250–499	6.6	—	—	3.2	2.7	9.0	.1	.8	1.4	1.0	24.8
500–999	11.4	.5	—	—	5.8	.3	—	—	.5	.3	18.9
1,000–4,999	2.9	.1	.1	5.1	12.2	1.5	1.2	4.7	.4	.3	28.5
5,000–9,999	6.3	.2	.4	8.5	4.6	6.6	1.0	2.0	1.9	.5	32.1
10,000–24,999	2.6	.8	.2	1.6	17.7	3.7	.9	.7	—	1.7	29.9
25,000 and over	4.7	.6	2.1	4.9	7.5	2.0	.3	.6	—	1.0	23.6
Total	4.1	.5	.9	4.6	10.8	3.3	.7	1.6	.5	1.0	27.9

Table 12a (Cont.)

Company Size by Number of Employees	Culture Operating Funds	Culture Capital Funds	Total Culture	Civic Causes	OTHER AREAS					Donee Unknown
					Religious Causes	Economic Education	Other Country Groups	Other Causes	Total Other	
					Percentage Distribution					
Below 250	.1	1.1	1.2	11.8	—	.4	.2	.5	1.1	—
250–499	4.1	3.4	7.5	5.9	.1	2.6	.1	4.6	7.5	—
500–999	1.6	—	1.6	6.9	—	—	—	8.0	8.0	.1
1,000–4,999	3.7	2.6	6.3	12.3	.3	.6	—	1.7	2.6	.9
5,000–9,999	2.6	1.8	4.5	11.4	.3	.5	.1	.9	1.8	4.0
10,000–24,999	1.8	—	1.9	9.6	—	.5	—	2.7	3.2	.3
25,000 and over	1.9	1.3	3.2	8.9	—	.3	.2	11.0	11.6	—
Total	2.3	1.3	3.6	10.2	.1	.5	.1	5.0	5.7	1.0

Table 13

Apportionment of Contributions in Companies with Twelve Smallest Contribution Budgets

			HEALTH AND WELFARE							
		Total Contributions	United Funds	National Health	National Welfare	Hospital Capital Grants	Hospital Operating Grants	Local Agencies	Misc. Capital Grants	Total Health & Welfare
Company	1	$ 2,090	$ 900	$200	$130	$ ...	$ ...	$ 300	$ ...	$1,530
	2	3,000	...	...	...	1,000	...	...	...	1,000
	3	3,540	2,675	350	100	...	30	110	...	3,265
	4	3,982	2,792	...	...	...	15	...	...	2,807
	5	6,144	2,447	...	...	...	...	...	...	2,447
	6	6,613	1,380	950	...	20	...	25	...	2,375
	7	6,991	1,520	...	...	...	...	...	...	1,520
	8	7,500	250	100	...	...	...	...	...	350
	9	8,000	3,000	...	...	...	...	...	...	3,000
	10	14,633	5,585	295	...	500	...	...	...	6,380
	11	16,000	8,500	500	...	...	...	...	...	9,000
	12	16,346	1,675	...	...	...	...	2,950	...	4,625

Table 13 (Cont.)

		EDUCATION										
		Scholarships	Fellowships	Research Grants	Capital Funds	Direct Unrestricted Grants	Indirect Unrestricted Grants	Education-related Grants	Other	Secondary Education Capital Grants	Secondary Education Other	Total Education
Company	1	$	$	$	$	$	$	$	$	$	$200	$ 200
	2											
	3											
	4	25						50			750	825
	5						1,107					1,107
	6	1,100										1,100
	7								5,056			5,056
	8					450	200		2,000			2,650
	9				3,000							3,000
	10								1,675		200	1,875
	11							500				500
	12	6,668	100									6,768

					OTHER AREAS OF SUPPORT						
		Culture Operating Funds	Culture Capital Grants	Total Culture	Civic Causes	Religious Causes	Economic Education Groups	Other Country Groups	Other Causes	Total Other	Donee Unknown
Company	1	$ 20	$	$ 20	$ 120	$	$ 50	$	$ 170	$ 220	$
	2								2,000	2,000	
	3	50		50			125		100	225	
	4	350		350							
	5	1,125		1,125	1,165		300			300	
	6	400		400	2,133				605	605	
	7	100		100					315	315	
	8					4,500				4,500	
	9	1,000		1,000	1,000						
	10				5,455		300	200	423	923	
	11	300		300	2,000		400	200	600	1,200	3,000
	12	500		500	2,600	200		200	1,566	1,965	

Education

Unrestricted grants remain the principal means by which industry offers its support of education. Such grants made directly to the institution are four times as large as those made through educational fund-raising organizations. The total of unrestricted gifts is 2½ times the magnitude of student aid in the form of scholarships and fellowships.

Turning again to Table 11, it will be seen that the manufacturing sector allots 41 cents of its budget to education, compared with 25 cents for nonmanufacturers. Petroleum companies allocate about half (49%) of their budget to education; they are followed by chemicals and allied products (47%) and electrical machinery manufacturers (45%). Judged by the 12 largest budgets reported in the sample, and analyzed in Table 14, our largest companies are more inclined to aid education than other causes.

Civic Projects

Although receiving but 9 cents of the gift dollar, civic causes continue to gain in importance in the eyes of business—primarily because they represent local needs, many of which have to do with inner city problems and the disadvantaged.

Chart I shows the order of priority assigned by companies to six categories of civic projects. The funding of programs having to do with community improvement generally is proving to be most attractive to business whereas mass transportation is of least concern.

Culture

Culture is another aspect of society that has caught the attention of the business community during recent years. Eight out of ten participants in this survey report expenditures on such projects accounting for 4 cents of the gift dollar.

Among the manufacturing firms, much above average support was provided by producers of stone, clay and glass products; and in the nonmanufacturing category, by the wholesale and retail trade and banking community.

Chart 2 enumerates some of the options for business involvement. Music, museums, and educational radio/TV are the art forms most frequently chosen by industry. Music, especially symphony orchestras, and museums were the top favorites in earlier Conference Board surveys. The present survey reveals the dance to be gaining in favor. Individual artists still fare badly when seeking noncommercial assistance from business.

Capital Gifts

Capital grants to all classes of beneficiaries of business were at a lower level than in 1970. Table 15 and the table [entitled "The Contributions Dollar," following Table 11] show the relative decline in capital giving in health and welfare, education, and culture. Funds contributed for other than operating expenses for hospitals, colleges, and universities represented the smallest share of the gift dollar ever recorded in these surveys. It is the experience of some cooperators that contributions to capital campaigns these past few years have enabled institutions to expand their facilities sufficiently to cope with current demands.

Business and Social Responsibility

Company contributions of dollars and gifts-in-kind to health and welfare, education, the arts, civic and other causes is but one of several ways in which business is exercising its leadership in social change. To cope with the many social issues facing our society, companies are introducing top-level changes in policy, in organization, and in operations. Numbered among such developments are: encouragement of employee participation in community affairs; hiring, and training practices to screen in the hardcore; investment in ghetto enterprises; participation in government-sponsored construction and rehabilitation of low-cost housing; creation of pollution control procedures to pretest the social and ecological effects of new products; establishment of policies setting forth social as well as profit objectives; and the formation of public affairs departments or appointment of executives in charge of public affairs.

The costs of such activities cannot be measured, but would exceed manyfold the equivalent dollar value of contributions and gifts analyzed in this report.

Table 14
Apportionment of Contributions in Companies with Twelve Largest Contribution Budgets
The Contributions Dollar

		Total Contributions	HEALTH AND WELFARE							
			United Funds	National Health	National Welfare	Hospital Capital Grants	Hospital Operating Grants	Local Agencies	Misc. Capital Grants	Total Health & Welfare
Company	1	$16,5[illegible]2,000	$3,445,000	$ 35,000	$ ...	$ 494,000	$18,000	$ 335,000	$ 450,000	$ 4,777,000
	2	14,089,000	7,174,000	64,000	350,000	1,110,000	...	243,000	1,113,000	10,054,000
	3	12,581,000	1,613,800	168,950	321,050	1,200,000	...	366,900	290,000	3,960,700
	4	12,300,000	3,800,000	10,000	150,000	400,000	...	1,850,000	...	6,210,000
	5	9,721,230	1,722,934	25,000	90,000	345,750	...	695,166	938,148	3,816,998
	6	6,732,000	1,405,000	38,000	55,000	36,000	...	86,000	300,000	1,920,000
	7	6,618,960	920,086	114,100	171,750	129,540	57,750	583,421	36,300	2,012,947
	8	6,577,881	1,724,788	2,000	106,243	314,850	40,304	109,390	78,534	2,376,109
	9	5,326,000	904,000	...	160,892	60,000	11,000	139,000	...	1,274,892
	10	4,656,860	1,972,410	68,500	40,000	222,500	...	42,500	187,000	2,532,910
	11	4,500,000	993,000	31,000	...	16,500	...	30,700	74,000	1,145,200
	12	3,804,500	647,500	2,000	22,000	20,000	900	33,500	15,000	740,500

		EDUCATION										
		Scholarships	Fellowships	Research Grants	Capital Funds	Direct Unrestricted Grants	Indirect Unrestricted Grants	Education-related Grants	Other	Secondary Education Capital Grants	Secondary Education Other	Total Education
Company	1	$1,693,000	$ 58,000	$ 383,000	$ 711,000	$ 130,000	$447,000	$ ...	$2,285,000	$ ...	$2,602,000	$8,309,000
	2	25,000	22,000	20,000	824,000	829,000	545,000	...	342,000	...	19,000	2,626,000
	3	239,000	654,000	902,800	1,385,200	3,391,200	235,500	254,900	...	...	7,400	7,070,000
	4	...	...	...	...	2,000,000	...	230,000	250,000	...	...	2,480,000
	5	618,150	...	217,000	455,500	1,213,807	157,500	38,750	286,000	...	1,463,545	4,450,252
	6	...	...	293,000	705,000	2,056,000	57,000	50,000	...	...	...	3,161,000
	7	10,050	31,700	173,500	95,000	524,600	50,000	...	2,224,381	...	242,334	3,351,565
	8	...	33,000	1,525,150	304,513	641,277	25,000	120,300	599,964	...	...	3,259,204
	9	...	...	...	...	2,061,000	32,000	26,000	246,000	...	460,000	2,825,000
	10	...	190,200	59,750	365,000	65,000	210,000	227,500	32,500	...	...	1,149,950
	11	43,000		157,000	55,000	2,027,200	...	53,700	375,000	...	...	2,710,900
	12	283,500	10,500	342,500	173,500	601,000	151,500	46,000	23,500	...	...	1,632,000

Table 14 (Cont.)

		Culture Operating Funds	Culture Capital Grants	Total Culture	Civic Causes	OTHER AREAS OF SUPPORT					Donee Unknown
						Religious Causes	Economic Education Groups	Other Country Groups	Other Causes	Total Other	
Company	1	$218,000	$ 27,000	$ 245,000	$1,592,000	$	$ 55,000	$ 74,000	$1,490,000	$1,619,000	$
	2	408,000	191,000	599,000	80,000	387,000	43,000	5,000	295,000	730,000	
	3	260,700	39,000	299,700	1,038,000	28,300		114,200	70,100	212,600	
	4	700,000	500,000	1,200,000	2,200,000		200,000	10,000		210,000	
	5	241,295	...	241,295	587,594		156,094	86,600	382,397	625,091	
	6	729,000		729,000	480,000		16,000	39,000	387,000	442,000	
	7	273,875	30,000	303,875	535,988		53,920	75,000	285,665	414,585	
	8	48,411	10,750	59,161	344,419		154,156	37,546	347,286	538,988	
	9	1,000		1,000	80,6000	1,730	109,000	25,000	283,378	419,108	
	10	119,250		119,250	110,500	...	...	...	744,250	744,250	
	11	70,000		70,000	158,000		2,000	99,000		101,000	314,900
	12	240,500	8,000	248,500	169,000	23,000	40,000	12,500	939,000	1,014,500	

Table 15

Capital Grants

Company Size by Number of Employees	Number of Companies	Total Contributions in Thousands	% of Capital Grants to Total Contributions	CAPITAL GRANTS					
				Total Grants in Thousands	Hospital in Thousands	Other Health and Welfare in Thousands	Higher Education in Thousands	Secondary Education in Thousands	Culture in Thousands
Below 250	11	$ 274	2	$ 5	$ 2	$ 2	$	$	$ 1
250–499	7	209	8	18	3	9	2	1	2
500–999	20	1,310	22	298	132	40	101	19	4
1,000–4,999	133	24,039	15	3,605	1,220	566	1,307	51	460
5,000–9,999	78	26,622	13	3,508	1,314	442	1,398	125	227
10,000–24,999	97	62,739	16	10,093	3,520	908	4,673	421	568
25,000 and Over	92	204,575	13	27,569	9,755	6,069	10,254	26	1,464
Total	438	319,770	14	45,098	15,948	8,037	17,738	645	2,729

Chart 1

Nonprofit Art Form

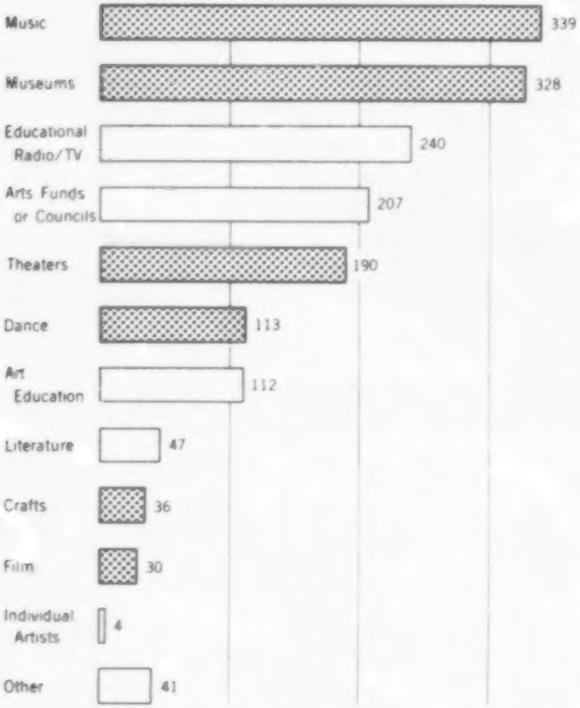
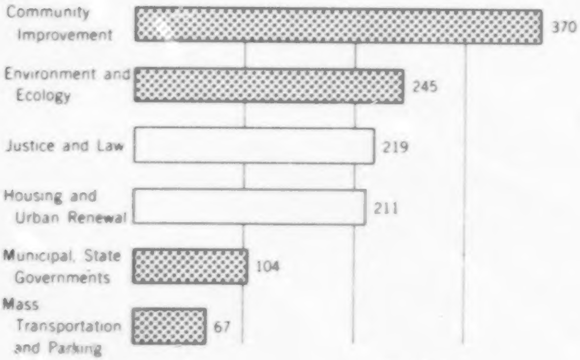
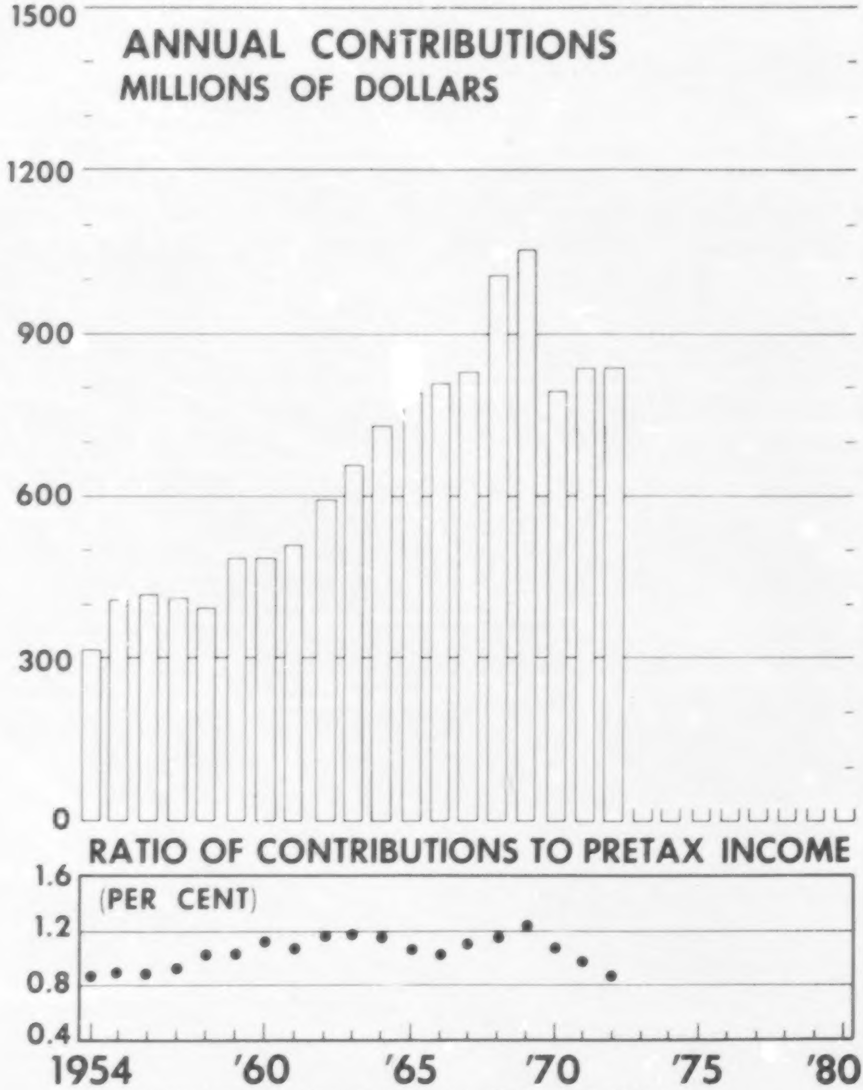


Chart 2

Civic Causes



CORPORATE CONTRIBUTIONS



SOURCES: INTERNATIONAL REVENUE SERVICE; THE CONFERENCE BOARD.
CONFERENCE BOARD CHART SERVICE ··· 9 – 73

Footnotes

1. American Association of Fund-Raising Counsel, Inc., *Giving USA*, 1973, p. 6, and *Giving USA*, 1975, p. 6, revised October 1975.

2. U.S. Bureau of the Census, *Statistical Abstract of the United States: 1974* (Washington, D.C.: Government Printing Office), Tables 377, 406.

3. American Association of Fund-Raising Counsel, Inc., *Giving USA*, 1975, p. 17.

4. E.G. Surrey, "Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance," 84 *Harvard Law Review* (1970) pp. 352-381-394.

5. This section owes much to the detailed discussion by Professor Phillip I. Blumberg in "Corporate Responsibility and the Social Crisis," 50 *Boston U.L. Rev.*, (1970), p. 157.

6. Treas. Reg. 62, Art. 562 (1921 Act).

7. E. Merrick Dodd, "For Whom are Corporate Managers Trustees?" 45 *Harvard Law Review* (1932), pp. 1145, 1148.

8. *A.P. Smith Mfg. Co.* v. *Barlow*, 13 N.J. 145, 98 A.2d 581 (1953), appeal dismissed, 346 U.S. 86 (1953).

9. In *Smith*, the court expressed reservations about gifts made indiscriminately or in support of a pet charity in furtherance of personal rather than corporate ends. For the tax treatment see, for example, *Sturgill Motor Co.*, 32 TCM 1336 (1973) (corporation denied a deduction for a gift to an alumni association that enabled its principal stockholder to become an association member).

10. *Model Business Corporation Act Annotated* (American Bar Foundation 1971, and 1973 supp.) §4(m). And see *Union Pac. R. Co.* v. *Trustees*, 8 Utah 2d 101, 329 P. 2d 398 (1958); *Theodora Holding Corp.* v. *Henderson*, 257 A.2d 398, 404 (Del. Ch. 1969).

11. The size of charitable programs carried on by a publicly held corporation has been an issue raised in recent years by professional stockholder groups, but it has received only nominal support. Blumberg, op. cit., p. 177, fn. 118; "Corporate Charitable Donations: Shareholders Protection and Public Disclosure," 5 *Columbia Journal of Law & Social Problems* 99 (August 1969), pp. 100-102.

12. Blumberg, op. cit., pp. 181-182.

13. Council for Financial Aid to Education, "Educational Contributions by Public Utilities and Other Regulated Industries as an Allowable Operating Expense for Rate-Making Purposes" (1972), pp. 37-38.

14. Ibid., pp. 3-36

15. However, life insurance companies, which are subject to special rules for computing taxable income, may under some circumstances have no deduction for charitable contributions. See Rev. Rul. 69-609, 1969-2 Cum. Bull. 146.

16. Internal Revenue Code of 1954. §170(b)(2).

17. Code §170(c)(2) and (3); Rev. Rul. 69-80, 1969-1 Cum. Bull. 65.

18. Code §170(e)(1) (A).

19. Code §170(e)(1)(B).

20. Proposed Treas. Regs. §1.861-8(e)(9)(iv).

21. *Giving USA*, 1975, op. cit., pp. 16-18, revised October 1975.

22. Rochelle O'Connor, "Corporate Contributions in Smaller Companies," Report No. 603, The Conference Board (1973).

23. J.H. Watson III, "Biennial Survey of Company Contributions," Report No. 606, The Conference Board (1973).

24. Insurance companies were not included in some of the survey's comparisons because of differences in computing income and assets.

25. Watson, op. cit., Tables 2, 3.

26. Ibid., p. 16, Chart 1. See also Consumer Subcommittee, Senate Committee on Commerce, 92nd Cong., 2d Sess., *Initiatives in Corporate Responsibility* (1972), pp. 10-11.

27. Clearinghouse on Corporate Social Responsibility, "Results of the 1973 Reporting Program of Life and Health Insurance Companies on Corporate Social Responsibility Activities" (December 1973), p. 11.

28. Watson, op. cit., pp. 1-3.

29. Watson, "The Impact of the Tax Reform Act of 1969 on Company Foundations," Report No. 595, The Conference Board (1973), pp. 35-36.

30. Watson, "Biennial Survey of Company Contributions," op. cit., pp. 1-3.

31. See Code § 4941(d) (1)(B)-(3).

32. Code § 4944(c); Treas. Regs. § 53.4944-3. Such investments are treated as grants for the purposes of the minimum distribution, expenditure responsibility, and taxable expenditures provisions. Treas. Regs. §§ 53.4942-3(a)(2), 53.4945-4(a)(2), 53.4945-5(b)(5), 53.4945-6(b)(1)(v)-(vi).

33. Treas. Regs. § 1.162-20. The political contributions credit, or deduction in lieu of the credit, is available only to individuals. Code §§ 41,218. Other prohibitions relate to corporate campaign contributions. Corrupt Practices Act (18 U.S.C. §610).

34. Treas. Regs. §§ 53.4945-4, 53.4945-5.

35. Code § 4945(a)(2).

36. Code §§11,243. The dividend received deduction (§ 243) is not available to private foundations in computing the 4 percent tax. Treas. Regs. § 53.4940-1 (e)(1)(iii), cf. § 53.4942(a)-2(d)(4)(i).

37. Substantially the same results could be achieved by a company if it made grants to organizations itself. However, a company could not claim a charitable deduction for a scholarship or other program for grants to individuals that it carried on itself.

38. Treas. Regs. § 53.4945-4(b)(5).

39. Tax Management Memorandum 73-22, p. 12 (BNA 1973). Compare Rev. Rul. 75-448, 1975-42 I.R.B. 6 (employee educational benefit trust).

40. Code § 117; *Lowell D. Ward*, 55 T.C. 275 (1970). All of the litigation over the income tax consequences of educational leave plans has involved direct company programs. The noncompany foundation sponsored tuition payments were not at issue in *Elmer L. Reese, Jr.*, 45 T. C. 407 (1966).

41. This would also exclude work-study programs such as that involved in *Michael A. Smith*, 60 T. C. 279 (1973).

42. Assuming that such plans produce taxable income to the employee, there is presented the problem of whether the tuition constitutes "wages" subject to withholding, FICA and FUTA taxes. In analogous cases the courts have stressed the lack of correlation between the amounts paid and the value of the employees services rendered to find payments are not "wages." *Royster Co., v. United States,* 73-2 USTC § 9480 (4th Cir. 1973) (meal reimbursements); *Stubbs, Overbeck & Associates, Inc. v. United States,* 445 F. 2d 1142 (5th Cir. 1971) (per diem allowances).

43. Code § 170(e)(1).

44. See *Singer Co. v. United States,* 449 F. 2d 413 (Ct. Cl. 1971); *Morris N. Scharf,* 32 T.C.M. 1247 (1973).

45. *Giving USA,* 1975, op. cit., p. 51.

46. Clearinghouse on Corporate Social Responsibility, op. cit., p. 21. A survey of corporate law departments indicated that some companies have begun to take affirmative steps to engage their lawyers in *pro bono* work. Consumer Subcommittee, Senate Committee on Commerce, *Initiatives in Corporate Responsibility,* op. cit., pp. 9-10, 13-16.

47. See Blumberg, op. cit., pp. 159-160.

48. Clearinghouse on Corporate Social Responsibility, "A Report on the $2 Billion Urban Investment Program of the Life Insurance Business, 1967-1972" (1973), p. 3.

49. _____, "Results of the 1973 Reporting Program of Life and Health Insurance Companies on Corporate Social Responsibility Activities," op. cit.

50. Consumer Subcommittee, Senate Committee on Commerce, *Initiatives in Corporate Responsibility,* op. cit.

51. Dr. Neal is president of the Committee for Economic Development.

52. Mr. Eells was executive editor and director, Program of Studies for the Modern Corporation, and an adjunct professor of business, Columbia University Graduate School of Business.

53. Mr. Turner was a vice president and director of the United States Steel Foundation, Inc.

54. Blumberg, op. cit., pp. 196-202.